CUTTING THROUGH THE RED TAPE: REGULATORY RELIEF FOR AMERICA'S COMMUNITY BASED BANKS

HEARING

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FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

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CUTTING THROUGH THE RED TAPE: REGULATORY RELIEF FOR AMERICA'S COMMUNITY BASED BANKS

Wednesday, May 12, 2004

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS,
AND CONSUMER CREDIT
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to call, at 10:02 a.m., in Room 2128, Rayburn House Office Building, Hon. Spencer Bachus [chairman of the subcommittee] presiding.

Present: Representatives Bachus, Baker, Gillmor, Biggert, Hensarling, Garrett, Brown-Waite, Barrett, Sanders, Maloney, Watt, Sherman, Meeks, Moore, Waters, Carson, Hinojosa, and Lucas of Kentucky.

Chairman BACHUS. [Presiding.] Good morning. The subcommittee will come to order.

Today's hearing was requested by Congressman Hensarling. We will focus on how to strengthen and preserve the important role that small banks serve in the communities by reducing the burdens imposed on those institutions by outdated and unnecessary regulatory requirements.

Among those testifying at the hearing will be Treasury Assistant Secretary Wayne Abernathy, Federal Deposit Insurance Corporation Vice Chairman John Reich, North Carolina Banking Commissioner Joseph A. Smith, on behalf of the Conference of State Banking Supervisors; and a number of industry and consumer group witnesses.

For generations, community-based banks have been the financial underpinning for millions of consumers, small businesses, family farms, local merchants and rural economies throughout the United States. Community-based banks form the building blocks of our nation's communities by providing credit to all geographic regions of the country. They have contributed substantially to the stability and growth of each of the 50 states by facilitating a decentralized source of lending. This dispersion of our nation's assets and investments helps preserve the safety, soundness, fairness and stability of our entire financial system.

Community banks are often the linchpin to the survival and well being of local communities, particularly small towns in rural America. They specialize in doing business in their respective cities and towns and reinvest their deposits into these communities through

local lending. Currently, more than 8,700 community banks with almost $2.3 trillion in assets continue in the tradition of giving back to their local communities through nearly 40,000 banking offices. Annually, community banks have made more than $3 billion in loans to small businesses, totaling over $275 billion and 720,500 loans to small farms, totaling more than $37 billion.

Recently, I introduced H.R. 591, which recognizes the importance of small banks in developing our communities and the nation as a whole, and designates April as Community Banking Month. I am hopeful this legislation will be considered on the House floor soon. Although small banks have been prosperous in recent years, they face a disproportionate regulatory burden in relation to their large bank counterparts. When a new regulation is created or an old regulation is changed, small institutions must devote a large percentage of the staff's time to review the regulation to determine if and how it will affect them.

In addition, compliance with the regulation can take large amounts of time that cannot be devoted to serving customers or business planning. Easing the regulatory burdens on small banks frees up more of the bank's resources for loans to small businesses and creditworthy borrowers, helping to promote economic growth and greater consumer choice.

In closing, I would like to thank Mr. Hensarling for working with us on this hearing. Congressman Hensarling recently introduced H.R. 3952, the Promoting Community Investment Act, which would require the banking regulators to give banks with less than $1 billion in assets the streamlined exam for compliance with the Community Reinvestment Act. Currently, streamlined CRA exams are limited to banks with less than $250 million in assets. This is just one example of Mr. Hensarling's strong commitment to issues affecting community banks.

I see Mr. Baker here. Mr. Baker has also made some significant proposals concerning deregulation.

The Chair now recognizes the Ranking Member of the subcommittee, Mr. Sanders, for any opening statement that he wishes to make.

[The prepared statement of Hon. Spencer Bachus can be found on page 52 in the appendix.]

Mr. SANDERS. Thank you, Mr. Chairman.

As a strong supporter of community banks and of credit unions, one of the concerns that I have, and Mr. Chairman, one of the issues that we might want to be addressing is to try to understand why throughout America and in my own State of Vermont, there are fewer and fewer community banks. One of the, in my view, very dangerous trends that is taking place within the financial services industry, as well as virtually every other industry in America, is that fewer and fewer large often multinational institutions are controlling those industries. The smaller guys, the people like community banks who know the folks in their neighborhood, who trust people, who have good working relationships, they are dissolving all over America. I think that that is a bad trend.

One of the topics that will be raised at this hearing will be an attempt to weaken Community Reinvestment Act requirements for mid-sized banks. Banking regulators have already proposed a regu-

lation to substantially reduce CRA requirements for 1,100 mid-size banks with assets of $250 million to $500 million, and legislation has been introduced to weaken CRA requirements for banks even further. If the proposed regulations go into effect and this legislation is signed into law, fewer people will realize the dream of homeownership; fewer small businesses will get off the ground; fewer jobs will be created; and fewer neighborhoods will be rebuilt. We must allow that to happen.

Mr. Chairman, CRA is making homeownership accessible to more Americans. It is helping to start small businesses and create decent-paying jobs. It is responsible for over $1 trillion in loans in low- and moderate-income communities. In my view the Community Reinvestment Act must be strengthened, and not weakened.

Mr. Chairman, I understand the focus of this hearing is to provide regulatory relief to community banks. I happen to believe that we need more small banks and credit unions, not fewer. I have met with community bankers, as well as credit unions in the State of Vermont, and I believe that they are doing a very good job. For example, they tell me that they are not pulling bait-and-switch credit card interest rate scams like many big banks are doing in this country. The reason it is important to have community banks, the reason it is important to have credit unions is that all over this country, people are being ripped off by large banks that are charging excessive fees, and extraordinarily high interest rates. That is why we need more community banks, not fewer.

But unfortunately, the massive deregulation of the banking industry over the past 2 decades has led to fewer and fewer small banks. This has been a disaster for consumers who have seen higher credit card interest rates and bank fees as a result. Mr. Chairman, according to a 2002 Federal Reserve study published in 2002 entitled Whither the Community Bank, “the number of small community banks with assets of less than $100 million has fallen from around 11,000 banks in 1980 to less than 5,000 today. About 55 percent of the bank mergers during the past two decades combined two community banks. These mergers would not have been possible without the repeal of federal and State banking regulations that historically restricted the size and geographic mobility of U.S. banks.”

Mr. Chairman, I am concerned that providing more regulatory relief in this instance could lead to even fewer small banks. Mr. Chairman, the issue you are touching upon today is important, but our goal must be to strengthen community banks, allow for diversity all over this country, and not to see fewer and fewer large institutions.

Thank you.

Chairman BACHUS. Thank you, Mr. Sanders.

Chairman Baker?

Mr. BAKER. Chairman Bachus, I want to commend you for your initiative in calling this hearing and your leadership in the past on seeking regulatory relief through the Congress for community institutions. I also want to say a word about Mr. Hensarling’s efforts and introduction of his own legislation and his initiatives in trying to bring additional relief to a critical part of our economy.

It is a clear fact that America is a nation of small businesses. Some testimony I read from this morning's presentation of witnesses indicates that 75 percent of all new jobs created in America come from companies with less than 500 employees. Frankly, I thought it was more like 90 percent of employment opportunities were created by companies with less than 25 employees. Whatever the number, it is clearly established that mom-and-pops are the employment engine in America today. They are the entrepreneurs. They are the innovators. They are the folks who bring products to market that we have not seen before.

Those folks do not get credit by going to Wall Street with their widget design. They start in small-town America; sit across the desk from the hometown banker who says, I have confidence in you, Joe; I am going to extend this credit to see how it works out.

The reality is that we are losing significant numbers of those community banking opportunities, that business engine development opportunity. One of the contributors, I happen to believe, is the plethora of regulatory interventions required by the federal government. Since 1989, I was shocked to learn by either agency or congressional action, 801 new regulations required of community-based institutions. Even for a conscientious person doing the best they can with lots of resources, that is a lot of change to absorb.

Second, as Mr. Sanders pointed out in his statement, we have gone from 11,780 institutions in 1989 to 4,390 defined as community banking institutions by 2003. That is a problem. Anyone concerned about concentration of economic assets in a handful of very large institutions has got to be troubled by these developments. These concerns must be addressed. The question I raise is, of course, where do we go? On March 17, Chairman Bachus authored a letter to the various federal regulators concerning the regulatory burden surrounding CRA, a letter which I cosigned with the Chairman because I believe that his request was certainly more than appropriate.

But rather than zero in solely on asset size, isn't what Mr. Sanders raised in his concerns this morning about inappropriate conduct and where credit is deployed really the key? Shouldn't we develop innovative ways to measure community institution performance, the percentage of loans that go to small businesses, the percentage of loans within a geographic area, the percentage of loans to low-income individuals, the percentage of loans held in portfolio because loans held in portfolio are generally nonconforming loans that cannot be sold off to the secondary market because there is some unique asset to that lending requirement that the banker thinks is good to extend the credit, but does not meet the cookie-cutter approach of Wall Street.

We have to get away from that. I suggest that providing regulatory relief after, not in front of, but after someone has demonstrated their extending credit to small business in their community, especially to low-income people and holding loans in portfolio might be the beginning of a measurement screen that enables this number of banks to go up instead of down. If we are in the middle of a jobless recovery, as some allege, I do not believe, this could be one change that might accelerate the growth of job opportunities.

Mr. Chairman, I stand ready to vote for and support any measure which you develop which will provide meaningful relief for this important engine of economic recovery.

Thank you. I yield back.

Chairman BACHUS. Thank you, Mr. Baker.

Mr. Sherman?

Mr. SHERMAN. Thank you, Mr. Chairman. Thank you for holding these important hearings. I hope we persuade the other body to take a look at H.R. 1375, the good work of this committee. I think we should focus on the recent actions of the OCC in preempting all State consumer protection laws for the big national banks. First, this is a disaster for states rights. Second, it is a disaster for consumers. And third, it is a potential disaster for those banks that are not national banks, since it creates an unequal playing field and since it also allows those who want to evade state laws to tarnish the name of all banks in the community, because the average American really does not draw a distinction between national and state-chartered banks in evaluating whether banks are doing a good job for our community.

When the 5 o'clock news is out there, to talk to a woman who has lost her home due to practices that the State legislature tried to protect her from, and where a runaway federal agency decided she should lose her home and should be subject to the very practices that a State tried to prohibit, when that 5 o'clock news appears, the public is not going to say, oh, but that was an OCC-regulated bank. Instead, your State legislatures are going to pass even more consumer protection laws, some of which may be ill-advised, which again will only affect those that are state-chartered, thus driving a consolidation, driving a migration to the national charter, and achieving what may be the purpose of the OCC, and that is to expand its regulatory market share.

So I look forward to us not only providing reasonable regulatory relief, but also make sure that when national standards are called for, they are the standards voted on democratically in this committee and in this House. And that they therefore apply to all banks, whether you have the national charter or the State charter, rather than a runaway agency providing a special benefit to only a segment of the banking industry, and in particular the segment that in general competes with the community bankers represented here.

I yield back.

Chairman BACHUS. Thank you, Mr. Sherman.

Mr. Hensarling?

Mr. HENSARLING. Thank you, Mr. Chairman. Thank you for holding this very important hearing.

Nearly every community throughout America is served by at least one small locally based and usually locally owned bank, which focuses on meeting the financial needs of the citizens living and working within that community. They are built on personal contact, communities ties and close lender-borrower relationships. They are often the economic lifeblood of rural America.

Chairman Alan Greenspan has called them, "one of the jewels of the international financial system," because of their uniqueness. They are our nation's community banks. They create jobs and hope

and opportunity, and they are threatened. In 1984, we had approximately 11,000 community banks. Today, the number is roughly half that.

One has to ask why. Now, if banking customers within a competitive marketplace are simply deciding through their free will they no longer want or need community banks, then we should not interfere. However, I fear that it is our interference in the first place which is helping cause the decline. When you ask community bankers what is the main obstacle they face in surviving and/or thriving, the answer is almost always the same: overly burdensome, costly and time-consuming federal regulations. Currency transaction reports, know-your-customer requirements, reg D, reg C, Community Reinvestment Act, Privacy Act notices, reg Z, and the list goes on and on.

The federal regulatory burden on smaller banks can be significantly disproportionate to their larger counterparts, especially for institutions with branches located in rural and more scarcely populated areas. This is mainly because the compliance costs for banks of all sizes contain a significant fixed cost component that all banks have to pay. These fixed costs will come out of a much smaller revenue base in a small bank. Larger regional or national banks can spread these costs out over a much larger revenue base.

I am convinced that action is needed to remove some of the restrictions on community banks and permit them to operate in a manner that preserves more resources for creating jobs, saving farms and serving their communities. When bankers tell me that they spend $300,000 per year on non-safety and soundness compliance alone, it is time that we take a hard look at their regulatory burden.

When I hear that two-thirds of many banks's total compliance costs are not even related to the safety and soundness of the institution, it is time we take a hard look at their regulatory burden. When community bank employees can spend more than 31,000 hours per year on compliance matters alone, it is time we take a hard look at their regulatory burden. When approximately one out of every four dollars goes to regulatory compliance for the average small bank, it is time we take a hard look at the regulatory burden.

So I believe it is imperative that Congress continue to examine the regulations that banks are forced to comply with, and act to remove or restructure antiquated and outdated regulations that stifle lending opportunities for banks working to serve their communities.

In many cases, the most burdensome of these regulations is the Community Reinvestment Act or CRA, which is why Chairman Baker and I have introduced legislation that would allow banks with less than $1 billion in assets to participate in a streamlined small bank CRA exam. $1 billion in assets appears to be the industry standard as well as the cut-off for the Federal Reserve.

Today, American consumers at all income levels have access to great credit products, great credit availability at low cost. We need to keep this phenomena alive, but excess regulation is harming that. So I look forward to working with you, Chairman Bachus,

Chairman Oxley and Chairman Baker, as well as other members of this committee to address these issues.

Thank you.

[The prepared statement of Hon. Jeb Hensarling can be found on page 57 in the appendix.]

Chairman BACHUS. Thank you.

Mr. Lucas?

Mr. LUCAS OF KENTUCKY. Mr. Chairman, I look forward to hearing from our witnesses.

Chairman BACHUS. Thank you.

Mr. Garrett?

Mr. GARRETT. Likewise, Mr. Chairman. I look forward to the testimony. Good to see you again, Mr. Abernathy. I commend you on holding these hearings.

The point that I will be interested to see at the end of the day is to what end as far as all the regulations that we have had, in the business world I guess it would be a cost-benefit analysis as to what has occurred over the years. From what I hear back at home, and what I hear in previous hearings, it has been a negative impact. I commend my colleague figuratively, but not literally, to my left, Mr. Hensarling, as far as the legislation he has put in play with regard to community bankers. What I am hearing back at home is that there is a negative impact, so I will be interested to see whether we can refute that or whether we can address that.

Also, in the hearings that we have heard to date in other committees and other subcommittees's hearing on money laundering and terrorism and those areas, the concern was the plethora of information that is coming into Washington today from all sources, financial and otherwise, that is just something that they just cannot keep up with. It goes back to the days prior to the PATRIOT Act with the $10,000 reports and now with the PATRIOT Act and others as well. They just literally cannot keep up with the information. So at the end, it is a question of to what end are some of these regulations that we have put in place; maybe it is doing, quite honestly, as Jeb's bill is saying, more harm than good both to an industry that is suffering under the weight of the burden and from our intelligence community as well, from the deluge of information that they really just cannot do anything with anymore.

So I appreciate your testimony today. Thank you.

Chairman BACHUS. Thank you.

If there are no more opening statements, we will go to our first panel. I have been told there are no more opening statements.

At this time, we will introduce our first panel. Our first panel, and I will introduce from my left to right, we have an esteemed first panel. Wayne A. Abernathy was sworn in as Treasury Assistant Secretary for Financial Institutions on December 2, 2002; nominated by President Bush on August 1, 2002 and confirmed by the Senate in November of that year. He brings more than 20 years of financial policy expertise to the position. He most recently served as the Republican Staff Director of the U. S. Senate Committee on Banking, Housing and Urban Affairs, where he also served as committee Staff Director to Chairman Phil Gramm from 1999 to 2001. I am sure you probably worked with Mr. Hensarling in that position.

His previous experience with the Senate Banking Committee includes serving as Staff Director of the Subcommittee on Securities. Prior to that, he was Republican economist for the committee. Prior to that, he worked as a Senior Legislative Assistant for Senator Gramm and as an economist for the Banking Committee Subcommittee on International Finance and Monetary Policy.

He earned his bachelor's degree from Johns Hopkins University, graduating with honors in 1980. He earned his master's in international economics, international law and organizations from Johns Hopkins.

I welcome you, Mr. Secretary.

Mr. John Reich became Vice Chairman of the FDIC board of directors on November 15, 2002. He served on the board since January of 2001. Following Chairman Donna Tanoue's resignation in July 2001, until Mr. Powell took office in August of 2001, he was Acting Chairman of the FDIC. He enjoyed a 23-year career as a community banker in Illinois and Florida, the last 10 years as President and CEO of the National Bank of Sarasota.

Before that, he served for 12 years on the staff of U.S. Senator Connie Mack. From 1998 to 2000, he was Senator Mack's Chief of Staff. His substantial community service includes serving as chairman of the board of trustees of a public hospital in Fort Myers, Florida and chairman of the board of directors of the Sarasota Family YMCA.

He holds a BS degree from Southern Illinois University and an MBA from the University of South Florida, and also is a graduate of Louisiana State University School of Banking of the South.

We welcome you, Mr. Reich.

Commissioner Smith is the North Carolina Commissioner of Banks, having been appointed in June 2002 to fill an unexpired firm of a retiring commissioner and was reappointed for a 4-year term in June 2003. Was that by Governor Easley?

Mr. SMITH. Yes, sir.

Chairman BACHUS. Okay. Prior to his appointment, Mr. Smith was counsel in the Washington office of the New York law firm of Thacher, Profitt and Wood, where he was a practitioner in the corporate and financial institutions practice group. Before moving to Washington, Mr. Smith served as general counsel and secretary of Centura Banks, now RBC Centura, in Rocky Mount, North Carolina, and engaged in the private practice of law in Raleigh.

A graduate of Davidson College and the University of Virginia Law School, he lives in Raleigh, North Carolina. He is married and has two grown sons. Any grandchildren yet?

Mr. SMITH. None that I know of, sir.

[Laughter.]

Chairman BACHUS. Okay. That is good.

We very much look forward to your testimony. I think our tradition is to start with Mr. Abernathy. Is that right? Have you all agreed on a different order?

Mr. ABERNATHY. We were flipping coins here for a while, but we only had a two-sided coin and it did not work out.

[Laughter.]

Chairman BACHUS. Whoever is most anxious can go first.

Secretary Abernathy?

STATEMENT OF HON. WAYNE A. ABERNATHY, ASSISTANT SECRETARY FOR FINANCIAL INSTITUTIONS, UNITED STATES DEPARTMENT OF THE TREASURY

Mr. ABERNATHY. Thank you, Mr. Chairman. It is a pleasure to be here with you and the members of the subcommittee today. This is a very good opportunity to testify on the regulatory burden faced by community banking institutions.

Small community banks and thrifts provide services that are greatly valued by their neighbors. I emphasize the word "neighbors." Their longstanding focus on individual customer relationships and in-depth knowledge of local credit needs serve our nation's communities well.

Of significant importance in achieving major goals set for us by President Bush, community bankers' expertise enables them to provide financial services to small businesses and hard-to-reach customers that might otherwise be overlooked. If we chose $1 billion in assets as the dividing line today between small banks and medium and large banks, the total number of small banks and thrifts declined from 1993 to year-end 2003 by almost one-third. Some have raised concerns about what these trends may mean for the future of community banking.

Fortunately, chartering activity in recent years demonstrates the vitality and attractiveness of community banking. According to the FDIC, there were over 1,200 new community banks and thrifts established since the beginning of 1992. Nearly all of these new institutions continue to serve their communities today.

The profitability of small banks and thrifts has been relatively stable over the past decade as measured both by return on assets and return on equity. It is true that small depository institutions have lower returns on equity than larger institutions, but that is in large measure because smaller banks tend to have more equity and are therefore more strongly capitalized than are larger banks.

Strong capital levels empower small banks to meet the particular and often unique business characteristics and credit needs of local households and the local businesses in their communities, while preserving the safety and soundness of the system.

Though we have great confidence in the strength and vitality of small banks and thrifts, they continue to face challenges from a variety of sources. A significant challenge arises from the burden that regulations impose. Many regulatory requirements carry some degree of fixed costs, but these can weigh more heavily upon the comparatively smaller revenue base of community banks.

To try to compensate for this imbalance, many of our laws, regulations and supervisory practices take into account differences between smaller and larger banking institutions in ways that help to mitigate potential competitive disadvantages. For example, banks and thrifts that have less than $250 million in assets are subject to a streamlined CRA test. Smaller depository institutions have more liberal access to Federal Home Loan Bank advances. At the end of last year, 2019 small banks and thrifts received the benefits of subchapter S corporation tax treatment, up from 604 institutions at year-end 1997.

Still, we believe that more can and should be done to reduce burdensome regulations without compromising prudential concerns.

This was reinforced by a recent call by President Bush that we should be sure that all federal, state and local regulations are absolutely necessary. An interagency task force under the direction of my colleague sitting next to me, FDIC Vice Chairman John Reich, has taken on this very important task. Last summer, the financial agencies published the first of a series of notices seeking feedback on three specific regulatory groups: applications and reporting, powers and activities, and international operations. In January of this year, a second notice was published requesting comment on consumer protection lending-related regulations.

This careful and comprehensive approach to the review of regulations could prove fruitful in identifying ways to reduce regulatory and compliance burdens on banks, especially on small banks, while also relieving corresponding strains on supervisory resources without sacrificing important supervisory objectives.

Earlier this year, the banking agencies also issued a proposed rule that would make more community banks eligible for streamlined CRA examinations. Institutions with under $500 million in assets would be eligible for this streamlined test. The agencies estimate that the proposal would cut in half the number of institutions subject to the large retail institution test.

Congress has joined this regulatory relief effort as well, moving forward several items of legislation. For example, the Treasury Department has consistently supported legislative proposals to repeal the prohibition on paying interest on business demand deposits. The House of Representatives has several times passed legislation that includes this repeal. Repeal would also benefit the nation's small businesses by allowing them to earn a positive return on their transaction balances.

Depository institutions of all sizes face a heavy regulatory burden. This burden falls disproportionately on small banks and thrifts. The costs are ultimately passed on to banks, consumers and taxpayers. When regulatory burdens are excessive and fail to add net value, they take a toll on the competitiveness of our financial system and on overall economic efficiency. The Treasury Department encourages efforts by the banking agencies to reduce regulatory burdens on banks of all sizes, an effort that is likely to benefit community banks and their customers in particular. We stand ready to work with Congress to further these objectives.

In closing, many have commented on the tremendous benefits we derive from our great dual banking system. When they do so, they usually refer to the dual system of state and national bank charters. But I think that we should include in that concept a vibrant, competitive array of banks of all sizes meeting the financial needs of our businesses and communities, which also come in all sizes, large and small. That is not only something worth preserving, it is something worth promoting.

Thank you, Mr. Chairman.

[The prepared statement of Hon. Wayne A. Abernathy can be found on page 61 in the appendix.]

Chairman BACHUS. Thank you.

Chairman Reich?

STATEMENT OF HON. JOHN REICH, VICE CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. REICH. Thank you, Mr. Chairman, for this opportunity to testify on a subject near and dear to my heart, the impact of regulatory burden on community banks.

As a former community banker with 23 years experience, 12 years as a community bank CEO, I hope to elevate the concern of Congress over the future of small community banks in the United States. To summarize and characterize my message to you this morning, Mr. Chairman and members of the committee, the small community banks of America face an uncertain future and may be in danger of becoming an endangered species.

Mr. Chairman, as you recently noted, community banks play a vital role in the economic well being of countless individuals, neighborhoods, businesses and organizations throughout our country, often serving as the lifeblood of our communities. I believe they are too important as sources of local credit and economic growth for us to sit idly by and watch them disappear due to the unintended consequences of past, present and future policy decisions, and also significantly due to the weight of accumulated regulatory burdens.

Most people recognize the considerable consolidation in the banking industry that has taken place over the last 20 years, but not everyone fully appreciates the extent to which community banks have been rapidly disappearing from the scene. As chart one indicates, at year-end 1984 there were 11,780 banks and savings institutions with assets of less than $100 million. I am talking about small community banks, making up nearly 78 percent of all FDIC-insured institutions in 1984. By the end of last year, that number had dwindled to 4,390, making up only 48 percent of the total number of institutions in the United States.

Even more dramatically, as depicted in the next chart, the total market share of small community banks has declined from 9 percent, this is an inflation-adjusted number, in 1984 to 2 percent at the end of last year. The size of the community banking industry in the United States, the small community banks, represent less than 2 percent of all industry assets. By contrast, as shown in chart three, the share of industry assets attributable to the largest banks in the country, those with more than $10 billion in assets, of which there are 110 banks, went from 27 percent at year-end 1984 to 70 percent of total industry assets at the end of last year.

It has been widely reported that the industry as a whole earned a record $120.6 billion last year, surpassing the previous record of the previous year of $105.1 billion set in 2002. But what is not often reported is the considerable disparity in earnings between the largest and the smallest institutions. It is indeed, as Chairman Don Powell of the FDIC recently said, a tale of two industries. Last year, the 110 largest banks with assets over $10 billion, which represent only 1.2 percent in number of the total institutions in the country, earned 73 percent of total industry earnings; 1.2 percent of the number of institutions represented 73 percent of total industry earnings. By contrast, the 4,390 community banks that represent 48 percent of the total number of institutions earned $2.1 billion in toto, just 1.7 percent of total industry earnings.

As chart four shows, the community bank share of industry earnings has been on a downward slope since 1990, and though I have seen no official projections going forward, I believe the trend is going to continue. Average return on assets for the industry as a whole last year was a record 1.38 percent. But when you dig deeper, you see that the large banks, those of $10 billion or more in assets, the 110 institutions that had $10 billion or more in assets, had an average return on assets of 1.42 percent, while the small community banks, under $100 million, had a return on assets of 0.95 percent.

As indicated on chart five, community banks with assets under $100 million generally operated at a higher profitability level than the larger banks in the past until the mid-1990s, when the lines crossed and larger banks began outperforming smaller institutions. I believe this disparity in profitability can be attributed at least in part to the disproportionate impact of the costs of compliance with accumulated regulations on community banks. Smaller institutions generally cannot absorb the costs and other burdens of regulations as easily as mid-size and larger banks. Since larger banks can spread the cost of compliance over many more transactions, the overall cost per transaction is often significantly lower for them than for community banks.

As chart six vividly indicates, there is a growing gap in the efficiency ratios of smaller versus larger institutions. Overhead costs are absorbing a much greater share of community bank revenues when compared to larger institutions. I believe that this, too, is a direct result of the disproportionate impact of regulatory burden on community banks. Since the enactment of FIRREA in 1989, the banking and thrift industry regulators have issued a grand total of 801 final rules, a tremendous number of rule changes for the industry to digest, particularly small community banks with limited staff. The cost involved in reprogramming computers, retraining staff, rewriting procedure manuals and producing new forms for some rules can be considerable.

So what are the regulators doing about this? Today, we are engaged in a concerted effort to review all of our existing regulations in an effort to identify and eliminate regulatory requirements that are outdated, unnecessary and unduly burdensome. The agencies have divided all of our regulations into 12 categories and are putting one or more categories out for comment every 6 months until the project is completed in 2006.

We are also conducting banker and consumer community group outreach meetings around the country to hear directly from all interested parties. Our interagency EGRPRA task force is responsible for reviewing and analyzing all the written and oral comments that we receive for possible regulatory burden reduction initiatives. The agencies will then propose amendments to their regulations as appropriate. In those cases where statutory changes are required to eliminate unnecessary burdens, we will recommend such changes to Congress.

I expect an interim set of recommendations to be made to Congress within the next few weeks, with a final report to Congress on the EGRPRA project to be submitted upon completion of the project in 2006. I want to emphasize that this is an interagency ef-

fort and all of the agencies are working together superbly in this effort.

Finally, I want to repeat my concern that if we do not do something in the near future to stem the tide of what bankers characterize as a continuing avalanche of ever-increasing regulation, I fear that America's community banks will continue their rapid disappearance from our towns and communities. That is why I believe it is incumbent upon all of us, Congress, regulators, industry and consumer groups, to work together in the short run to eliminate outdated, unnecessary and unduly burdensome regulations and to develop longer-range solutions, including the possibility of a two-tiered system of regulation for the two very diverse industries which make up our banking system today in the United States.

In closing, Mr. Chairman, I wish to thank you again and your colleagues for holding this hearing on the impact of bank regulation on community banks today, and I look forward to your questions.

[The prepared statement of Hon. John M. Reich can be found on page 123 in the appendix.]

Chairman BACHUS. I thank you. That was compelling testimony, Vice Chairman Reich, indeed. I am not sure that that has been widely publicized, some of the facts that you have gone over. I very much appreciate it. You have been very valuable to this committee moving forward.

At this time, I would like to recognize the gentleman from North Carolina, Mr. Watt.

Mr. WATT. Thank you, Mr. Chairman. I believe you have already introduced my State Banking Commissioner, Joe Smith, but I appreciate your extending the courtesy to me to extend a personal welcome to him, and rave about the magnificent job that he has done in North Carolina.

North Carolina, of course, has a great reputation for its national and State banks. The regulation at the State level and the supervision at the State level is a testament to the leadership of our State banking commissioner. I appreciate the opportunity to welcome him here and put him on a national platform. I look forward to his testimony.

Thank you.

Chairman BACHUS. Thank you.

Congressman Watt is a valuable member of our committee and we appreciate him giving us that additional introduction.

Mr. SMITH. Thank you for those kind words.

Chairman BACHUS. Thank you.

Mr. SMITH. One gets so few in this business.

[Laughter.]

Chairman BACHUS. You ought to use those to campaign for office.

[Laughter.]

Mr. SMITH. No, thank you.

[Laughter.]

Chairman BACHUS. Commissioner?

Mr. WATT. I think I embarrassed him, so he forgot to turn on his microphone.

Mr. SMITH. It is on. I am just naturally quiet and soft-spoken. (LAUGHER)

Mr. WATT. Okay.

STATEMENT OF HON. JOSEPH SMITH, JR., COMMISSIONER OF BANKS, NORTH CAROLINA OFFICE OF COMMISSIONER OF BANKS, REPRESENTING CONFERENCE OF STATE BANK SUPERVISORS

Mr. SMITH. Good morning, Chairman Bachus, Representative Watt, members of the subcommittee, I am Joseph A. Smith, Jr., North Carolina Commissioner of Banks and Chairman of the Conference of Sate Bank Supervisors's Legislative Committee.

Thank you for inviting CSBS here today to discuss strategies for supporting our country's unique community banking system. To support our diversified system of community banking, CSBS and the State banking commissioners are now working with the federal financial institutions examination council to implement EGRPRA. This process has highlighted several insights that we believe should inform this committee's work. I should say, that we hope will inform your work.

First, a bank's most important tool against regulatory burden is its ability to make meaningful choices about its regulatory structure. The State banking system sets our financial system apart from every other developed nation and is a primary contributor to our nation's diverse and responsive economy. But diversity in our financial system is not inevitable. Community banking, as the charts just showed, is not inevitable. Both are products of a consciously developed stated-federal system.

The state charter has been and continues to be the charter of choice for community-based institutions because the supervisory environment, locally oriented, hands-on and flexible, matches the way these banks do business. A bank's ability to choose its charter encourages regulators to operate more efficiently, more effectively and in a more measured fashion. A monolithic regulatory regime would have no incentive to efficiency. The state system remains as a structural curb on excessive federal regulatory burden and a means of promoting wide diversity of financial institutions.

Second, while our current regulatory structure does recognize differences between financial institutions, it too often imposes one-size-fits-all requirements that are unduly burdensome on smaller or community-based institutions. Regulatory burden always falls hardest on smaller institutions and state-chartered banks tend to be smaller than their federally chartered counterparts.

The Conference of State Bank Supervisors asked its Bankers Advisory Board about regulatory burden. Their responses illustrated how disproportionately heavily the regulatory burden falls on smaller institutions. One member of our Banker's Advisory Board, the CEO of a $150 million bank, reported that his bank employs the equivalent of four or five full-time employees who focus exclusively on compliance, rather than on customer service or lending. This commitment places the bank at a competitive disadvantage not only to larger banks, but also to non-bank financial services providers that are not subject to many federal banking regulations.

We suggest that Congress and the regulatory agencies seek creative ways to tailor regulatory requirements for institutions that focus not only on size, but on a wider range of factors that might

include geographic locations, structure, management performance and lines of business. Every new national standard is generally a new regulatory burden for the majority of banks. Regulatory relief for the handful of market-dominating banks that operate in multiple states usually means new and unanticipated regulatory burdens for the thousands of community banks that operate in a single state or even a single community.

Third, while technology continues to be an invaluable tool of regulatory burden relief, it is not a panacea. Technology has helped reduce regulatory burden in countless ways. State banking departments, like their federal counterparts, now collect information from their financial institutions electronically, as well as through on-site examinations. Shared technology allows the State and federal banking agencies to work together constantly to improve examination processes, while making the process less intrusive for financial institutions.

The fact that technology makes it so much easier to gather information, however, should not keep us from asking whether it is necessary to gather all of this information or what we intend to do with this information once we have it. Information gathering is not cost-free.

Fourth, no amount of legislative reform can be effective unless regulators coordinate to reduce unnecessary duplication. The regulatory structure that makes choice possible in our banking system also creates a complex network of overlapping, sometimes contradictory regulations and policies. Coordination among regulatory agencies is the only way to eliminate unnecessary duplication, while preserving diversity in our system. CSBS brings state and federal regulators together in a variety of forums to improve communication and coordination among states and with federal agencies.

Finally, although regulators constantly review regulations for their continued relevance and usefulness, many regulations and supervisory procedures still endure past the time that anyone can remember their original purpose. Many State banking statutes include automatic sunset provisions that require legislators and regulators to review their laws at regular intervals to determine whether they are still necessary or meaningful. We urge Congress to apply this approach to as wide a range of federal banking statutes as possible.

The current trend toward greater more sweeping federal preemption of State banking laws and a push toward uniformity weighs against all of the insights I have just discussed. We appreciate that the largest financial services providers want more coordinated regulation. We share these goals, but not at the expense of distorting our marketplace, denying our citizens the protection of state law, or eliminating the diversity of regulation and institutions that makes our financial system the envy of the world.

The regulatory environment for our nation's banks has improved significantly over the last 10 years, in part, sir, because of your vigilance. As you consider additional ways to reduce burden on our financial institutions, we urge you to remember that the strength of our banking system is its diversity. While some federal intervention may be necessary to reduce burden, relief measures should

allow for further innovation and coordination at both the State and federal levels.

The continuing effort to streamline our regulatory process, while preserving the safety and soundness of our nation's financial system, is critical to our economic well being, as well as to the health of our financial institutions. State bank supervisors continue to work with each other, with our legislatures and with our federal counterparts to balance the public benefits of regulatory action against their direct and indirect costs.

We commend you, Mr. Chairman and the members of this subcommittee, for your efforts in this area. We thank you for this opportunity to testify and look forward to any questions that you and the members of the subcommittee might have.

Thank you very much indeed.

[The prepared statement of Hon. Joseph A. Smith Jr. can be found on page 170 in the appendix.]

Chairman BACHUS. I thank you, Commissioner Smith.

At this time, the panel will ask questions. I will start by asking Mr. Abernathy. Mr. Abernathy, Chairman Powell recently suggested that policymakers might want to consider a two-tiered approach in pricing of deposit insurance between the large complex banks and the smaller institutions. I think Vice Chairman Reich suggested the possibility of expanding this two-tiered approach to other areas of bank regulation. What are your views? What are the possible benefits of separate regulatory regimes and also some potential downsides?

Mr. ABERNATHY. Mr. Chairman, from a general point of view, to the degree that you can tailor the costs of regulation and the details of regulation to the nature of the institutions you are supervising, to the extent that you can do that, you are improving the quality and the effectiveness of your regulations and reducing unnecessary costs. So conceptually, it is a great idea. That is one of the reasons why we have supported with all of the other financial regulators a package for FDIC reform that would give increased flexibility to the FDIC to run their fund much the same way an insurance company would, which is matching the cost of the insurance with the risk that is presented. We think that makes a lot of sense.

Chairman BACHUS. My next question, Title V of Gramm-Leach-Bliley has imposed some significant financial burden or regulatory burdens on our small institutions. One of them is the privacy notice, which I think most of us agree a lot of them have very little benefit to the consumers, who indicate that a large number of consumers find them confusing. I know that bank regulators have solicited public comments on ways to improve these privacy notices. Do you agree that the current system needs to be improved? Has the Treasury developed any recommendations for both easing the compliance burden on banks, particularly smaller banks, and making the privacy notices themselves more meaningful for consumers?

Mr. ABERNATHY. Mr. Chairman, one of the first assignments that I had in my current responsibility as Assistant Secretary was looking at these notices. In that process, I have yet to find anyone who is satisfied with the current State of the notices. I do not travel very much in the attorney circles. Maybe there are some attorneys

who are happy with the notices because they seem to be made for attorneys, by and for the use of attorneys, perhaps, but they do not benefit consumers. I do not find any consumers who feel that they are getting information they can use. The financial institutions I talked to, they indicate that these notices carry significant costs to provide, and yet they wonder if they are providing any benefit to their customers.

So for now over a year, Treasury has been advocating that we ought to simplify significantly the Gramm-Leach-Bliley privacy notices so that they present in the types of information that customers can use and understand, and make use of at the time that they are making their consumer decisions. We have looked at, as an example, the information notices that are provided with food labeling. There we have some very important information. It is important to consumers that they can understand it, that it is presented in a format that is easy for them to grasp. We encourage the regulators to move forward and look for something that is that easy to use and understand.

Chairman BACHUS. I appreciate that.

Vice Chairman Reich, I know the FDIC and its fellow bank regulators have recently proposed regulations that would update CRA. Many of us on the committee are concerned that CRA, while a well-intended attempt to promote investment in the local community, may have had actually the opposite effect of strangling community banks with red tape and making it more difficult for them to meet their customers's credit needs.

Can you explain to the committee how the recently proposed CRA regulations address those concerns? Are there other reforms that the regulators are considering that would further CRA's underlying objectives, while at the same time easing the compliance burden on our community banks?

Mr. REICH. With respect to the proposed changes in CRA, Mr. Chairman, the agencies have proposed to increase the threshold for large bank compliance from $250 million to $500 million. The impact of this would cover about 1,100 banks in the country and would not relieve them of compliance and CRA responsibilities. They would continue to be subject to the lending requirements of the Community Reinvestment Act. But it would streamline the examination process and relieve them of some of the burdens of compliance with the Community Reinvestment Act.

In my view, community banks are the personification of community reinvestment in their communities. They are concerned about their communities. They each have boards of directors who are actively involved in their communities; who care about their communities; who care about their bank and its impact on the community. So I believe that the small community bank about which I am so concerned carries out the spirit and the purpose of the Community Reinvestment Act every day that it is open for business in its community.

With regard to the proposed increase from $250 million to $500 million, in my own personal view, I would have liked to have seen it go to $1 billion, because I really believe that the definition of a community bank today encompasses institutions up to $1 billion.

The proposed move to $500 million is a very good move that will provide some relief for community banks.

Other areas that we are working on, we do have, or did have recently a revised privacy notice out for comment. It was an effort to produce a simplified privacy notice. I think it was an improvement, but it has not been universally received as a great improvement by the banking industry. Small community banks feel that if they do not share information with anyone, why should they have to send out a privacy notice every year to their customers? They would like to be relieved of that responsibility and be required to file a privacy notice only when they change their practices. If they are a local institution that does not share information with any other agencies, they would prefer to file privacy notices only when their policies change.

Chairman BACHUS. Okay. Thank you. We appreciate your remarks and look forward to your continuing to work with us to find ways to reverse what appears to be some negative trends for our community banks.

At this time, what we are doing on both sides is going in order of members's arrival. At this time, I would recognize Ms. Carson. Do you have questions for the panel?

Ms. CARSON. Thank you very much, Mr. Chairman. I think they have answered my questions in terms of where they are. My concern is where we are as a committee in terms of continuing to infuse local communities with tax credits and financial support in various neighborhoods to continue to rebuild neighborhoods in America. I am afraid your strategy here may injure that process, but we will wait and see. I appreciate your comments.

Chairman BACHUS. Okay. I thank the lady.

At this time, Mr. Watt?

Mr. WATT. Thank you, Mr. Chairman.

Welcome again, Commissioner Smith. I hope I did not embarrass you with my earlier welcome.

Let me ask you, Commissioner Smith, North Carolina and 15 other states, plus Puerto Rico, either have usury laws or interest caps or direct laws dealing with payday lending. That is an issue that has traditionally been handled at the State level, is it not?

Mr. SMITH. Yes, sir. That is correct.

Mr. WATT. Generally, the federal regulators pretty much stay out of the way of that?

Mr. SMITH. Yes.

Mr. WATT. Mr. Reich, I am advised that the OTS, the Federal Reserve and the OCC each have taken steps to prevent regulated institutions from renting or using their charters to enable payday lending where there are state laws that prohibit it. Why is it that the FDIC is the only bank regulator that has not done that?

Mr. REICH. Congressman, the FDIC has developed the reputation of being soft on payday lending because we have not exclusively restricted payday lending activities. I think it is our view that there is a market of underserved people who are being served by payday lending, and that certain kinds of payday lending activities, if tightly supervised and controlled, do not represent safety and soundness concerns to the banks who engage in those activities. We have not opened the door to payday lenders at the FDIC.

Mr. WATT. Do you have criticism of the other regulators that have specifically prohibited their member institutions or banks under their regulation from renting their charters?

Mr. REICH. No, I am not here to criticize any other agency for their approach toward payday lending.

Mr. WATT. How do you reconcile the FDIC's position with those other regulators?

Mr. REICH. I think we are comfortable with the restricted nature, with the restricted environment under which we permit payday lending activity to take place in institutions. We limit payday loans on the books of our institutions to 25 percent of their capital. Typically, we require them to fund their payday loans with $1 of capital for every $1 of payday loans that are on their books. It is essentially self-funding with their own assets.

Mr. WATT. But where a State has prohibited that activity in that particular state, isn't that in effect a substitution of your judgment for the judgment of the State lawmakers and/or regulators who have made a judgment about that particular activity in that state?

Mr. REICH. We are not cheerleaders for payday lending, Congressman.

Mr. WATT. I am not asking you whether you are cheerleading for it. I am just trying to reconcile where you are with the other regulators. I guess my concern is there is an ongoing kind of tug-of-war, not intentional tug-of-war, but ongoing debate about what the States will have control over and what the federal government will have control over. When you have something that has clearly been regulated by the States, and there are specific statutory provisions that deal with it, I am trying to figure out why the federal regulator, one in particular, one out of four, would fail to honor that.

Mr. REICH. There are very few institutions in the country involved in payday lending, and not many states involved. It is an issue that we are not championing; that we have been reactive to, not proactive about. Those institutions that are under our domain that are engaged in payday lending activity, we feel they are subject to the terms and conditions of our supervisory guidance, and we have been comfortable with our experience.

Mr. WATT. Since this is a hearing about regulatory relief, maybe I should ask the question, how many regulations has the FDIC issued in this area that is imposing additional burdens, whereas if they just said we are going to honor the States, wouldn't that reduce some regulatory burdens?

Mr. REICH. I do not have an answer to that question, Congressman.

Mr. WATT. I yield back.

Chairman BACHUS. Thank you.

What I am going to do, because I actually recognized two on this side, and I am going to recognize Mr. Hensarling and then go to Mr. Garrett. And then we will be back in order.

Mr. Hensarling?

Mr. HENSARLING. Thank you, Mr. Chairman.

Gentlemen, I have the honor and privilege of serving the Fifth Congressional District in Texas, which stretches almost from downtown Dallas to the piney woods of East Texas. I have had the opportunity in that capacity to meet with community banks in urban

Dallas, suburban Dallas County and in rural East Texas. In speaking to these community bankers, and granted this is an unscientific survey, universally they seem to tell me that well over half, up to two-thirds of their compliance costs, has nothing to do with the safety or soundness of their institutions.

Have your institutions conducted any surveys? Do you have a feel if these results are accurate? Starting with you, Secretary Abernathy.

Mr. ABERNATHY. Congressman, I learned my banking from Texas bankers, so I would give a lot of credit to what they have to say.

Mr. HENSARLING. So do I.

Mr. ABERNATHY. But having said that, we have not conducted any kind of what I would call a scientific survey of that. I think there would be great value in doing that. I think to the extent we ask our safety and soundness regulators to engage in a lot of other types of activities, we have to ask ourselves, are we distracting them from their number one responsibility, which is the safety and soundness of the financial system. I think that would be a very valuable exercise.

Mr. HENSARLING. Thank you.

Mr. Reich, do you have a comment?

Mr. REICH. I think the Federal Reserve did a study last in 1999, which indicated that the costs of compliance totaled approximately 12 percent to 13 percent of non-interest expenses, a number I think approaching $40 billion annually for the industry.

Anecdotally and in the outreach meetings that I have had with bankers around the country in the past year, they tell me the same kinds of comments that you are hearing, that the additional operating costs in recent years have been substantially attributable to the costs of compliance. I think it is borne out in one of the charts that I presented, which was a chart of a bank's efficiency ratio, the ratio of its non-interest expenses to its total operating revenue. In the last 7 or 8 years, the efficiency ratios of community banks in comparison to larger banks have been flat or increasing, largely attributable to compliance costs.

Mr. HENSARLING. Thank you, Mr. Reich.

Unfortunately in the interest of time, Mr. Smith, I think I am going to move on to another subject.

I have read in a Congressional Research Service Report that a streamlined CRA Exam can save 40 percent of a bank's overall compliance costs. Speaking to the same Texas bankers that I alluded to earlier, many cite the large bank CRA exam as their number one compliance cost. Assuming CRS got it right, is there any data point that we have that proves that banks that engage in a small bank CRA exam somehow are serving their communities less than those who are subject to the larger test? Do we have any hard data on this?

Mr. Smith, we will start with you.

Mr. SMITH. Thanks. To my knowledge, sir, the answer to that question is no.

Mr. HENSARLING. Okay. Mr. Reich, do you have any information?

Mr. REICH. I do not, Congressman.

Mr. HENSARLING. Okay. Secretary Abernathy?

Mr. ABERNATHY. I have not seen any data that says that.

Mr. HENSARLING. Okay, next question. Obviously, we have a line of demarcation presently between the large exam and the smaller exam at $250 million in assets. Myself and Chairman Baker have proposed a bill to move that to $1 billion. Mr. Abernathy and Mr. Reich, I think both of you cited in your testimony the $1 billion figure as your line of demarcation for the small bank. That appears to be the Federal Reserve definition. It appears to be industry standard. So I am curious, what is the derivation of your feeling that $1 billion ought to be the line of demarcation?

Mr. ABERNATHY. It is certainly nothing scientific, frankly. It seems to be a number where when you draw that line and you look at the banks that are below that line, they seem to fit the image that most people have of what community and local banks are. When you have the largest bank in the country having assets in excess of $1 trillion, to say that the line you are going to draw is one one-thousandth of that size suggests to me, if you are trying to define the difference between the large and the small, that certainly is not drawing the line too high.

Mr. HENSARLING. Mr. Chairman, if I could ask one more question to Mr. Reich. I have had one banker in Athens, Texas ask me: Congressman Hensarling, who reads all these reports that my bank has to fill out? What do I tell this gentleman?

Mr. REICH. Consumer groups read the data. The data is collected by our staffs and it is put back out into the public arena. It is massaged and manipulated as the users see fit. When I started in banking in 1961, the call report form was one page, two sides, one piece of paper. Today, it is 40 pages long. And whether you are a $10 million bank or a $10 billion bank, you fill out the same report. There are some supplemental reports, but there is so much information that I believe could be eliminated from the reporting requirements.

Mr. HENSARLING. Thank you.

Thank you, Mr. Chairman.

Chairman BACHUS. Thank you.

Mr. Garrett?

Mr. GARRETT. Just a flippant comment, I guess. If the consumers had to pay for these reports themselves, then I guess we could save a lot of money on the other end. Maybe not.

Before there was the PATRIOT Act, there was the Bank Secrecy Act. Now, I am not a constitutional attorney. I am just a plain slip-and-fall attorney, so I never did quite understand what the constitutional underpinning was of the Bank Secrecy Act, that when I engage in a financial transaction with this individual, a bank, I give up some of my rights; and when I engage in a financial transaction with somebody else, I do not give up those privacy rights. So I will just put two questions to you.

At the very least, is there any consideration being given to raising the threshold as far as the Bank Secrecy Act, as far as what triggers reporting the $10,000 figure up to a more realistic higher number of $20,000, $30,000 or higher? Although I know there were earlier court cases on it, I would appreciate your opinion as to the constitutionality of this requirement that I have to turn over my private information in that manner as we currently do.

Mr. ABERNATHY. Congressman, with regard to the level of the CTRs, it is really a factual issue. The question is, at what level do we draw the line that is going to give us the kind of information that is important in fighting the crooks that want to make use of our financial system, whether it is the terrorist, the mobsters or whoever else.

That is a factual question that we are constantly asking. Right now, the law says it is at $10,000. Is that too high, too low? I think we need to continue to evaluate the data and say if we drew that line at a different place, what would the result be with regard to the ability to halt money laundering. I do not think it should be a static number. I think it is something we should continue to investigate, and in fact it is something we do continue to look at.

Mr. GARRETT. Maybe along that line, just following Mr. Hensarling's question, who looks at that information? This is not consumer groups that are looking at this information. This is law enforcement that looks at this information. What is the word that you get from law enforcement as to the value of this information? I understand that it is just a deluge of reports that are coming in and in order for them to weed through, it is the proverbial needle in the haystack approach. Can you cite any specificity as to the value of these reports to law enforcement and their use?

Mr. ABERNATHY. It is really looking for the needle in the haystack. When you want to find that needle in the haystack, you do not want to pile on more hay. You want to remove some of the hay, but you do not know where the needle is so you do not know where to move the hay. That is why it really is a factual exercise that we engage in with financial institutions. We ask them, where should we look; where don't we need to look.

Frankly, we get our best information from the suspicious activity reports (SARS) because they provide more detailed information. To the extent that we can put this information in electronic form, we can digest it and use it more effectively. That is why we have been trying to encourage financial institutions to provide the information as much as possible electronically, because we can use it better that way.

Mr. GARRETT. I guess that is another area where I have to scratch my head as far as making the law enforcement and making the banks and the community banks an extension of law enforcement as far as suspicious activity reports as well. I do not think most of them said, when I am getting into the banking business, I am getting into law enforcement at the same time.

What sort of feedback, then, is there between Treasury and the banks, so to speak, on the suspicious activity reports and the validity of these reports and the value of the reports? I think this is something that was moving up along the line time-wise on the PATRIOT Act. This is where it is supposed to be going on.

Mr. ABERNATHY. I think there are significant conversations that take place, but I think we need to have more. The new Chairman of the Financial Crimes Enforcement Network, FinCEN, Mr. Bill Fox, has particularly given tremendous emphasis to finding out from the financial institutions themselves just what is most effective, and helping them know what they are providing that we can use.

Mr. GARRETT. Very briefly, can you say that in a timeline, shall we look to any changes within the next month, 6 months, 1 year, 2 years as far as any of these numbers or activities?

Mr. ABERNATHY. I am hopeful that on a continuing basis, within the next several months, within the next year, to see some improvements, significant and important improvements in our anti-money laundering efforts.

Mr. GARRETT. Thank you.

Mr. REICH. May I address that question, Congressman Garrett?

Mr. GARRETT. Are you going to give me the constitutional basis for that? Certainly, you can answer.

Mr. REICH. I have had six outreach meetings with bankers over the last 9 months across the country. This issue is at the top of their list. Twelve million CTRs were filed by the banking industry last year. We are working with Director Fox at FinCEN. We have had some very good conversations. He came to our outreach meeting in Nashville 3 weeks ago. He is very interested and anxious to work with us in developing a process and processes which will be more efficient. He has expressed a hope that by the end of this year, that there will be some reform to the CTR process.

What form that will take, I cannot say. There has been some discussion of raising the threshold for businesses. I want to emphasize, though, that the banking industry is not looking to escape from this responsibility. Bankers are patriots. They are good citizens. They want to continue to be. But to the extent that there can be greater efficiency put into the process, the filing of CTRs, they are hopeful that we can accomplish efficiency in the process.

Mr. GARRETT. I thank you for that. I see my time has run out. If I had the time, I would just ask you about your extension as far as your reporting is being done by 2006 as far as your hearings, and how many community banks we may have lost by that time, and whether that can be contracted in any manner.

Mr. REICH. When I first undertook the project, I thought it would only take a year to a year-and-a-half to complete, but it is a mammoth undertaking and it does require a 3-year time period in order to give it thorough consideration.

Mr. GARRETT. Thank you.

Chairman BACHUS. Thank you, Congressman Garrett.

Did you say you were a slip-and-fall attorney?

[Laughter.]

He does not show any ill-effects.

[Laughter.]

Mr. Hinojosa?

Mr. HINOJOSA. Thank you, Mr. Chairman.

I want to say that at the present time, I am reviewing Mr. Hensarling's legislation, H.R. 3952, entitled Promoting Community Reinvestment Act, which should allow community banks with less than $1 billion in assets to participate in a small bank institution CRA examination.

I want to determine if this legislation is the appropriate regulatory relief to consider at this time, or if we should wait until the regulators complete their regulatory relief review. I am also reviewing the Independent Bankers Association of Texas's idea for a community bank charter. I welcome their appearance here today.

Mr. Chairman, I want to ask a question of Vice Chairman Reich. You state in your testimony that the volume and complexity of existing banking regulations, coupled with the new laws and regulations, may ultimately threaten the survival of our community banks. That concerns me, because they play a very important role in my 15th Congressional District in Texas.

You later note that community banks are healthy in terms of their supervisory ratings, but are operating at a lower level of profitability than the largest banks in the country. You also contend that credit unions, on the other hand, have a number of regulatory advantages over banks and thrifts, and Congress should reexamine these advantages and see if they can resolve them.

What particular regulatory legislation would you recommend that Congress enact? And how do you recommend Congress or regulators establish a level competitive playing field for our community banks and their counterparts?

Mr. REICH. Thank you for that question.

You mentioned Congressman Hensarling's proposal to increase the limit on CRA from $250 million to $1 billion. As one regulator, I would be very supportive of that effort, and as one regulator who has talked with thousands of bankers in the past 3 years, that would have a major impact on their institutions in a positive way.

There are a number of other steps, and frankly I would not want to see the committee or the Congress wait until 2006 until our comprehensive review is totally completed, to enact legislation which would relieve regulatory burden. When there are good ideas existing such as that one, I would hope that it could be enacted as soon as possible.

There are a number of regulatory issues, Congressman, which bankers are concerned about. I mentioned the Bank Secrecy Act. That actually is an area that would not require statutory or congressional approval. I think the Treasury Department has all the authority that it needs to make changes there. There are a number of other areas that bankers are concerned about. Regulation D, the limitations on transfers and withdrawals from money market deposit accounts, was a regulation that was enacted in the mid-1980s, and is a regulation which in today's economic environment seems to no longer make sense.

As I indicated earlier, I expect to be coming to the Hill within the next few weeks with a platform of legislative recommendations which will emanate from our first year of activity on this EGRPRA regulatory reduction effort. I think that changing the threshold CRA certainly would be a major assistance to community banks.

Mr. HINOJOSA. How will we be able to get a copy of that platform of recommendations that you propose to bring us?

Mr. REICH. I assure you, I will hand-deliver it to your office.

Mr. HINOJOSA. We certainly have the community bankers visiting members just like myself, and expressing those concerns, and looking at the charts of what has happened to profitability of small community bankers versus the large ones, it is a matter of concern to those of us who have such large rural districts.

In closing, Mr. Chairman, I want to ask, or rather make a statement more than a question. I want to thank Ms. Judith A. Kennedy for stressing in the testimony I read prior to her formal pres-

entation here today, how important it is that we fully fund HUD's Section 8 voucher program. I have cosigned Ms. Nydia Velazquez's letter to the House appropriators requesting such funding.

With that, Mr. Chairman, I yield back the balance of my time.

Chairman BACHUS. Thank you.

We will now recognize Mr. Meeks. That will then conclude the questioning for the first panel. I believe, Mr. Abernathy, you have an engagement and need to leave at quarter of. We tried to facilitate that, so we will recognize Mr. Meeks and then close the first panel.

Mr. ABERNATHY. Thank you, Mr. Chairman.

Mr. MEEKS. Thank you, Mr. Chairman.

Let me first say, I just want to make sure of some concerns with regard to the CRA because I have found that CRA is good business, not only good for local communities, but it is good business for the financial institutions also. I know that for some of the small banks, we are trying to eliminate some of the paperwork and make sure that they do not get caught under the deep files.

So let me ask Mr. Abernathy, how much relief do you think the changes in CRA requirements for banks under 500K provide? Do you have any idea?

Mr. ABERNATHY. That is a factual question. I think the process that we are engaged in, during the comment period, should reveal to what extent that will be a benefit; whether that is the right line to draw. Certainly, the question has been asked, and I think there is a lot of validity to it, namely is to what extent do you need to remind community banks to do business in their communities. I think, frankly, in my experience, any community bank that is not doing banking in its own community is not going to stay in business very long.

Mr. MEEKS. Let me ask this, then, in regard to some of the banks that would be exempted based upon the proposed rules from rigorous CRA standards, are you aware of any previous patterns of violations of CRA requirements by any of those, or antidiscrimination laws by any of those institutions?

Mr. ABERNATHY. CRA is not an antidiscrimination statute, as you know. CRA's main requirement is that banks are to do business in the communities where they are located. There are other antidiscrimination statutes.

Mr. MEEKS. Right. I am saying either/or, understand that.

Mr. ABERNATHY. Yes. I believe violations that have occurred have been fairly small, but I think they have been by some small institutions, but still a very minor number, a minuscule number of institutions.

Mr. MEEKS. Do you have any idea of how these banks generally have scored on CRA examinations?

Mr. ABERNATHY. The smaller banks?

Mr. MEEKS. Yes.

Mr. ABERNATHY. The vast majority of them have obtained satisfactory examination scores.

Mr. MEEKS. Right.

Mr. Smith, let me ask you a question. Do you think there would be any community banking system without a State banking system?

Mr. SMITH. I think that the evidence that we have so far is that most community banks are state-chartered banks; that most community banks being created now are state-chartered banks. Other things equal, I think there would be many fewer community banks without a State system.

Mr. MEEKS. What do you think is the greatest threat to the State banking system?

Mr. SMITH. The greatest threat to the State banking system is, in my opinion right now, the perception that the comptroller's actions with regard to preemption have created an advantage which will lead at the margin to larger state-chartered institutions considering more seriously flipping charters to the national system. If that happens, then our written testimony has some stats in it. There could be a significant decrease in the State system in the number of total assets, which is the assessment base on which the whole system rests. I think that is a serious issue, frankly, for the Congress because ultimately this body is going to be in control of that issue.

Mr. MEEKS. I agree with you.

Do you think consumers generally recognize the difference between state-chartered and nationally chartered banks?

Mr. SMITH. I think consumers generally recognize the difference between a local bank and a bank that is not local. I have formed, I will say by way of background, we have had 10 new charters issued by my agency in the last year, and the story I hear is always the same story. It is the leadership of small business people who believe that larger institutions, for good reasons and bad, do not serve the needs of the community in the way they used to when they were smaller. I try to talk them out of it, frankly, because starting a bank is a rough business, but they are not dissuaded. Many people in many parts of North Carolina, at least, believe very strongly that a locally established, locally controlled institution is very important, in fact crucial to their economic development. I hear this over and over again.

Mr. MEEKS. Do you think that disclosure requirement would be helpful, if national banks were required to disclose to consumers that they did not follow State consumer protection laws because there is a difference, you know. Some federally chartered banks may not provide the same consumer protections.

Mr. SMITH. I would prefer, frankly, to have a system where there is an even playing field, where that is not required. Actually, some of my best friends are national bankers, so I do not think it is a question of burdening them. I think it is a question of being sure that the playing field is in fact even. That is more of a concern to me personally.

Mr. MEEKS. Thank you.

Let me ask Mr. Reich one quick question. In reading your written testimony, you do not make any comments on the FDIC and the payday lending issue. In this committee, different members have had various opinions on the use of it as a financial instrument. My biggest concern is the FDIC's role in allowing banks to partner with payday lenders so that they can circumvent state law, an issue that we are also dealing with regarding to OCC.

What do you feel should be some of the best practices for payday lenders and the bank affiliates?

Mr. REICH. As I indicated to an earlier question on this subject, the FDIC is not a cheerleader for payday lending. We have issued guidance for the industry and for our examination personnel that indicate under what conditions payday lending activity may take place, and have placed strong capital requirements on those institutions that are involved in payday lending activity.

We believe that it is an activity that carried on at a moderate level does not pose safety and soundness problems for those banks that we supervise that are involved in that activity.

Mr. MEEKS. Okay. I guess I am out of time. I yield back, Mr. Chairman.

Chairman BACHUS. Thank you.

I want to again thank this panel for their testimony. Without objection, your written statements in their entirety will be included in the record, as will the opening statements of the members, if there is no objection, and any written questions that the members may wish to submit. Ms. Ginny Brown-Waite of Florida has two questions specifically for Mr. Abernathy and Mr. Reich, which we will submit to the record along with any others.

I want to conclude by saying that I think your testimony today is an alarm bell for what Chairman Greenspan has said is the crown jewel of our banking system, and that is our network of community banks, which he pointed out is really unique worldwide in their scope, their diversity and their mission. It is something that is a treasure to our country and its people, both to rural America, to agriculture, but to small business and to many of our small cities and towns. It gives consumers choice.

I join Vice Chairman Reich in saying that I have serious concerns about the future of community banking, and see a regulatory burden on them as an important factor in the equation for their future success. We have in recent years given beneficial treatment to some of their competition. I believe that that is beginning to show up in the facts and statistics we have heard today. I think the answer to that is extending benefits and regulatory relief to our community banks. I think that would be the approach to so-called level the playing field.

With that, the first panel is discharged and we thank the gentlemen. Watch your step as you leave.

I would like to welcome the second panel. At this time, I am going to recognize the gentleman from Texas, Mr. Hensarling, to introduce our first witness.

Mr. HENSARLING. Thank you, Mr. Chairman.

I am privileged and honored to introduce Mr. Jim Goldston, who happens to be the President of City Bank, that is City Bank with a "y." In Forney, Texas, they know how to spell "city." He is the President of City Bank in Forney, Texas in Kaufman County which I have the privilege of representing as part of the Fifth Congressional District.

Mr. Goldston has not only been a bank President, but also has the unique attribute of having previously been a bank examiner as well, and brings a unique perspective to this particular hearing. In addition, I just think to a great extent Mr. Goldston represents

what is good, what is unique about community banking in Texas and I wager in America. Not only has he worked to make a very successful bank, but he has previously served as the President of the Chamber of Commerce. He has served on two different committees of the school district. He has been the President of the Lions Club. He has been a deacon in his church. He has been a hospital board member. He served as a director on the North Texas Council of Substance Abuse.

Mr. Chairman, I read this items out to let you know that by definition community banks have to be involved in their communities. Indeed, it goes back to buttress the argument that they are indeed the lifeblood of many of our rural communities. It is with a great honor and privilege that I introduce Mr. Goldston to our committee.

Chairman BACHUS. I thank you and welcome, Mr. Goldston.

Our second witness, Mr. Dale Leighty, is chairman of the Independent Community Bankers of America; chairman and president of the First National Bank of Las Animas. We talked yesterday, and I have been through there. That is a lovely town. Dale, we welcome you. That bank is a $125 million asset bank in the northeast corner of Colorado. He is also the past President of the Independent Bankers of Colorado.

In addition to his leadership in the community banking industry, he serves on numerous civic organizations, including volunteering as treasurer of his local Lions Club chapter, executive committee member of the Bent County Development Foundation. That is where Bent Fort is in Las Animas, which is a historic fort. He is also active, as is Mr. Goldston, and the gentleman from Happy, Texas, very active in his local church, where he serves many youth groups. He graduated from Kansas State University. We welcome you, Dale, to today's hearing.

Our next witness is Bradley Rock, chairman of the board, President and CEO of the Bank of Smithtown and Smithtown Bancorp, it is a public holding company, for the past 15 years. That is in Long Island, New York. During his tenure, the market value of the company stock has risen by more than 2000 percent, and the Bank of Smithtown has been recognized by several magazines and rating services as the number one community bank its size in the United States. That is quite an accomplishment.

He also serves as vice chairman of the Governmental Relations Council of the American Bankers Association, and he is representing that association today.

I may have said, Mr. Leighty, you are actually representing the Independent Community Bankers of America at the hearing.

So we welcome you, Mr. Rock.

Mr. ROCK. Thank you.

Chairman BACHUS. Our third witness is Mark Macomber, President and CEO of Litchfield Bancorp in Litchfield, Connecticut, a $162 million mutual organization where he has been since 1993. He serves as President and CEO of Connecticut Mutual Holding Company, a multibank mutual holding company that includes Northwest Community Bank in Winsted, Connecticut as an affiliate. He is a member of the ICB board of directors and executive

committee. As are our other gentlemen, he is active in many community activities, including President of the United Way.

Our next witness is Judith Kennedy. We welcome you back to the committee. She serves as President and CEO of the National Association of Affordable Housing Lenders, representing American lenders in moving private capital to those in need. Under her leadership, the NAAHL has become recognized as the premier authority in the nation's capital on private lending and investment in low- and moderate-income communities.

Prior to joining NAAHL, Ms. Kennedy managed government relations at two Fortune 100 financial corporations, Sallie Mae and Freddie Mac. Her government service has included staff positions on the Senate, as well as on this committee, on the House Banking Committee. As I said, welcome back. She has many awards and community activities, including DC Youth Orchestra Foundation. So, we welcome you today.

Our next witness is John Taylor. You have testified before the committee prior to this. I think it was last year. He is President and CEO of National Community Reinvestment Coalition. He is on the board of directors and is chairman of the executive committee of America Works Partnership, an AFL-CIO national organization to stimulate job development in poor urban areas. He also serves on the board of directors of the Association for Enterprise Opportunity. He also is the current chairman of National Neighbors, a pro-diversity organization and has made appearances in many foreign countries promoting economic justice matters. We welcome you back to the committee.

Did you mention to us last time that you had run for Congress? That would have been in Massachusetts. We welcome you back.

Our last witness is J. Pat Hickman. He is the President and CEO of Happy State Bank, so it is obviously a bank in good shape.

[Laughter.]

He is current volunteer chairman of the Independent Bankers Association of Texas. He is also very active in his community and his church. He put an investor group together in 1989 to purchase Happy State Bank in Happy, Texas. The bank was a $100 million bank with one office and five employees. The bank has expanded to eight communities, Happy, Canyon, Amarillo, Stratford, Dalhart. That is on the Colorado Southern Railroad, isn't it? Dumas, Sunray and Panhandle, with 11 total offices. In fact, it is a railroad town, isn't it? Yes, like a lot of towns. Its assets total $290 million and he employs 130 people. I would like to welcome you.

I would like to go back and mention that Mr. Macomber is on the board of directors of American Community Bankers, not ICBA. I think I said ICBA and I wanted to correct that. You are actually testifying on behalf of America's Community Bankers, which we well know the difference, so I do not know what I was thinking. We welcome you, and you represent a fine organization.

With that, we will start from my left to right. The first witness is Mr. Goldston.

Mr. GOLDSTON. I would like to ask that the written comments be made a part of the record.

Chairman BACHUS. I am sorry. I did omit to say that without objection, your written statements will be made a part of the record.

You will each be recognized for a 5-minute summary of your testimony. So thank you for reminding me of that.

STATEMENT OF JIM GOLDSTON, BRANCH PRESIDENT, CITY BANK, (TX)

Mr. GOLDSTON. Mr. Chairman and members of the committee, I am honored to appear before you today to discuss the importance of community banks to our nation and to ask for your help in reducing unnecessary and burdensome regulations.

My name is Jim Goldston. I live and work in Forney, Texas, a small town just east of Dallas. Congressman Jeb Hensarling will soon represent our community and I am here today at his invitation.

I have worked in banking for over 20 years, and the past 5 years I have been branch President for City Bank. That is C-I-T-Y, not C-I-T-I. But for 3 years, I was a bank examiner for the Texas Department of Banking. During that time, I observed many banks both good and bad, and gained some understanding of how state and federal regulations can and should improve the safety and performance of our banking system to benefit and protect both our customers and our FDIC deposit insurance structure.

As an ex-examiner, I have the deepest respect for our regulatory forces. Like bankers, they have a tough job digesting and enforcing an ever-growing mound of regulations. I only want to point out today some consequences, probably unintended consequences, of regulations that affect community banks like us.

We are a small but growing bank with just over $800 million in assets spread across 12 communities in west and north central Texas. We offer a full range of financial services to our customers, focusing on doing what we can to meet the financial needs of our customers and growing the economies of our local communities, while earning an acceptable return for our shareholders. One-hundred percent of our stock is owned by residents of the communities we serve, and over 63 percent is owned by my fellow bank employees and their families. Each year, our bank adopts 73 different policies covering all facets of our operation and addressing the hundreds of regulations now in place.

Last year, we paid over $565,000 to our internal compliance and audit staff and over $160,000 to outside firms just to be sure that we are complying with applicable regulations and policies. These figures do not include the expense of our other employees's time spent actually in complying with those regulations. It also does not include the cost of the time spent by our state and federal regulators checking up on our checking up.

We believe that regulations should either improve the safety and soundness of our financial system or improve the services we give our customers. Those that only add to the paperwork burden should be abolished. I have gone into more detail in regards to some of the burdens dealing with a few of the regulations in my submitted testimony.

Now, I would like to share with you in a graphic way the paperwork burden on just one type of loan, the home mortgage loan. Recently, I personally refinanced my mortgage. This is the stack of paperwork that my wife and I had to sign at closing. As we began

to sign the papers, my wife asked me if I understood what it is all about. I responded, of course, I am a loan officer. I know what these documents do and say. When I looked more closely at one of the disclosures, I realized that truly I was not familiar with this form.

If a traditional mortgage closing is confusing to an experienced bank officer, how much more confusing is it to the average customer? This stack includes disclosures mandated by truth-in-lending, Real Estate Settlement Procedures Act, Flood Disclosure Protection Act, Gramm-Leach-Bliley Act, Internal Revenue Code, title insurance requirements. At application time, there were disclosures to comply with the Equal Credit Opportunity Act, Home Mortgage Disclosure Act, Fair Housing Act and the U.S. PATRIOT Act, just to name a few.

Finally, the expansion of the small bank classification for CRA rules has greatly helped many community banks, but many of us are still caught in a web of trying to comply with the rules for advanced testing designated for massive complex nationwide organizations that bear little resemblance to even the biggest community banks. The current review of banking regulations taking place on the Economic Growth Recovery and Paperwork Reduction Act is a good start on seriously reviewing regulatory burden, but it must be coupled with statutory change as well. Many of the burdensome requirements described in this testimony are not a matter of regulation, but rather mandated by statute. We community bankers implore you to seriously take up reduction of regulatory burden. As a community banker, I, like my peers, want to serve my community with reasonably priced products, home loans, small business loans, agriculture loans and deposit products in investment services, but the cost of unnecessary and burdensome regulations increases my cost while not truly benefiting the public. Please make real regulatory burden relief a reality.

Thank you.

[The prepared statement of Jim Goldston can be found on page 65 in the appendix.]

Chairman BACHUS. Thank you, Mr. Goldston. I think you and Mr. Hensarling are going to get along just fine.

[Laughter.]

Mr. Leighty?

STATEMENT OF DALE LEIGHTY, CHAIRMAN AND PRESIDENT, FIRST NATIONAL BANK OF LAS ANIMAS, (CO) REPRESENTING INDEPENDENT COMMUNITY BANKERS OF AMERICA

Mr. LEIGHTY. Mr. Chairman and members of the subcommittee, my name is Dale Leighty, as you mentioned. I am chairman of the Independent Community Bankers of America and president and chairman of First National Bank of Las Animas, Colorado, a $140 million community bank located in southeast Colorado.

I would like to thank the subcommittee for examining the important issue of regulatory relief for community banks. This is one of ICBA's top priorities, and I am pleased to testify today on behalf of our nearly 5,000 community bank members to share with you our views and concerns.

ICBA supports a bank regulatory system that fosters safety and soundness. However, statutory and regulatory changes continually increase the cumulative regulatory burden for community banks. In the last few years alone, community banks have been saddled with the privacy rules of the Gramm-Leach-Bliley Act; the customer identification rules and other provisions of the USA PATRIOT Act; and the accounting, auditing and corporate governance reforms of the Sarbanes-Oxley Act. Yet relief from any regulatory or compliance obligation comes all too infrequently, while new ones just keep being added.

There is not any one regulation that community banks are unable to comply with. It is the cumulative effect that is so burdensome. As ICBA President and CEO Cam Fine recently stated, "Regulations are like snowflakes. Each one by itself may not be too much, but when you add it all up, it could crush the building."

Regulatory and paperwork requirements impose a disproportionate burden on community banks because of our small size and limited resources. We have had to devote so much of our resources and attention to regulatory compliance that our ability to serve our communities and support the credit needs of our customers is diminished.

Regulatory burden is a perennial problem for community banks. In 1992, Grant Thornton conducted a study for ICBA on the cost of complying with the 13 bank regulations that were deemed the most burdensome for community bankers. At that time, over 10 years ago, the annual compliance costs for community banks for just 13 regulations was estimated to be $3.2 billion. In addition, the study found that 48 million staff hours were spent annually to comply with just those 13 regulations.

ICBA is pleased that, at the direction of Congress under the Economic Growth and Regulatory Paperwork Reduction Act of 1996, the federal bank regulators are now reviewing all 129 federal bank regulations, with an eye to eliminating rules that are outdated, unnecessary or unduly burdensome. We wholly applaud this effort and fervently hope that it bears fruit.

However, Congress must recognize there is only so much that the regulators can do to provide relief since many regulatory requirements are hard-wired in federal statutes. Therefore, effective reduction of regulatory burden will require congressional action, and ICBA strongly urges the Congress to be bold and open-minded when considering recommendations offered by the regulators and the industry for relief.

The litany of burdensome regulations is long. To name a few, truth-in-savings, truth-in-lending, real estate settlement procedures, electronic funds transfer; fair lending, privacy notices, insurance disclosures, funds availability notices, the Home Mortgage Disclosure Act, currency transaction reports, suspicious activity reports, call reports, regulation O reports, regulation D reports, the Bank Secrecy Act, and Community Reinvestment Act, just to name a few. These regulations are overwhelming to the 37 employees of my bank who must grapple with them every day.

CRA is a clear example of regulatory overkill. It deserves special mention since there is a pending regulatory proposal to reduce the community bank regulatory and examination burden. Evaluating

the CRA performance of large complex banking organizations and small locally owned and operated community banks using the same examination standards simply does not make sense.

ICBA strongly supports an increase in the asset size limit for eligibility for the small bank streamlined CRA examination process. While we prefer that it be raised to $2 billion, we applaud the regulators's proposal to increase the limit to $500 million in assets and eliminate the separate holding company qualification. Chairman Bachus, we appreciate the letter you and Congressman Baker organized in support of the proposal.

ICBA also strongly supports Congressman Hensarling's legislation, H.R. 3952, calling for an increase in the CRA small bank size limit to $1 billion, although again we would support amending the bill to raise the threshold to $2 billion.

While community banks will still be subject to CRA under the regulatory or legislative proposal, many will be free from the more onerous compliance burdens associated with the large bank CRA examination, allowing us to focus on serving the needs of our customers.

Community banks pose different levels of risk to the banking system and have different abilities to absorb the costs of regulatory burden than large national or regional banks. Therefore, the ICBA strongly urges Congress and the regulators to continue to refine a tiered regulatory and supervisory system that recognizes the differences between community banks and larger, more complex institutions. Less burdensome rules and/or appropriate exemptions for community banks are the hallmark of a tiered regulatory system.

In conclusion, ICBA member banks are integral to our communities. However, regulatory burden and compliance requirements are consuming more and more of our resources to the detriment of our customers. And because the community banking industry is slowly being crushed under the cumulative weight of regulatory burden, many community bankers are giving serious consideration to selling or merging with larger institutions and taking the community bank out of the community.

The ICBA urges the Congress and the regulatory agencies to address these issues before it is too late. My written statement includes more detail including an appendix with detailed discussions of the regulatory burden of selected regulations.

The ICBA strongly supports the current regulatory and legislative efforts to reduce regulatory burden. We look forward to working with you to identify statutory and regulatory changes that should be made to ensure that the community banks remain vibrant and able to continue to serve our customers and our communities.

Mr. Chairman, thank you for the invitation to testify today. I will be happy to answer your questions.

[The prepared statement of Dale Leighty can be found on page 97 in the appendix.]

Chairman BACHUS. Thank you, Mr. Leighty.

Mr. Rock?

STATEMENT OF BRAD ROCK, CHAIRMAN, PRESIDENT AND CEO, BANK OF SMITHTOWN (NY) REPRESENTING AMERICA'S BANKERS ASSOCIATION

Mr. ROCK. Thank you, Mr. Chairman.

As you noted earlier, I am the chairman of Bank of Smithtown, a 95-year-old, $625 million community bank located on Long Island in Smithtown, New York. I am glad to present the views of the ABA. Reducing regulatory burden is an important issue for all businesses. This morning, I would like to make three key points.

First, regulatory burden is not just a minor nuisance for banks. It has a significant impact upon our customers and upon local economies. Over the past 25 years, it has steadily grown and now permeates all levels in the bank, from frontline tellers to the CEO. Based on research in the 1990s, the total cost of compliance today for banks is between $26 billion to $40 billion per year.

Certainly, many of the regulatory costs are appropriate for safety and soundness reasons and for consumer protection. But if this burden could be reduced by 20 percent and directed to capital, it would support additional bank lending of between $52 billion and $78 billion. The impact on our economy would be huge.

Secondly, regulatory burden is significant for banks of all sizes, but pound for pound, small banks carry the heaviest load. Community banks are in great danger of being regulated right out of business; 8,000 of the nation's 9,000 banks have less than $500 million in assets, and 3,350 of those banks have fewer than 25 employees. These are the banks that are providing credit and deposit services to people in small towns across America, yet these same community banks do not have the human resources to run the bank and to read, understand and implement the thousands of pages of new and revised regulations they receive every year.

A week ago, I was with a fellow community banker in Georgia who told me that his bank, with only 20 employees, has had to add a full-time person for the sole purpose of completing reports related to the Bank Secrecy Act. Community banks in such circumstances will not be able to survive for long.

To illustrate the magnitude of this burden on small banks, consider this. Each year the ABA publishes a reference guide which summarizes and outlines the requirements embodied in thousands of pages of regulations. This summary is 600 pages long and will be even longer next year to cover new responsibilities under the USA PATRIOT Act and the expanded HMDA reporting requirements.

I personally spend about one-and-a-half days per week just on compliance issues. Some CEOs tell me that they are now spending nearly half of their time on regulatory issues. This means that bank CEOs spend over 5.5 million hours per year on compliance, time that could have been better spent on improving their businesses and meeting the needs of their customers.

Many of these regulatory efforts provide little or no meaningful benefit to bank customers. As a banker and a lawyer, I can tell you that, for example, at real estate settlements customers do not read the piles of documents they are required to sign. In fact, the only people who read these voluminous forms are the bank staffers who are required to complete them and process them.

My third and final point is this: We are hopeful that the review of regulatory costs by the federal bank regulators will reduce the compliance burden. Many bankers are skeptical, however, as we have seen previous efforts at regulatory relief come and go without noticeable effect, while the overall level of regulatory burden has kept rising. It may take congressional action to make a difference.

The bottom line is that too much time and too many resources are consumed by compliance paperwork of little or no benefit to customers or investors, leaving too little time and resources for providing actual banking services. The losers in this scenario are bank customers and the communities that banks serve.

Thank you for the opportunity to present our views.

[The prepared statement of Brad Rock can be found on page 154 in the appendix.]

Chairman BACHUS. Thank you.

There are five votes on the floor. We think that we will take, Mr. Macomber, your testimony now, and then we will recess until 1 o'clock, because Mr. Sanders and Mr. Hensarling do have some questions. So we will take your testimony and then recess until 1 o'clock.

STATEMENT OF MARK MACOMBER, PRESIDENT AND CEO, LITCHFIELD (CT) BANCORP, REPRESENTING AMERICA'S COMMUNITY BANKERS

Mr. MACOMBER. Good afternoon.

Chairman Bachus, Ranking Member Sanders and members of the subcommittee, I am Mark Macomber, President and CEO of Litchfield Bancorp in Litchfield, Connecticut. Litchfield Bancorp is a $162 million state-chartered community bank, part of a two-bank mutual holding company.

I am also representing America's Community Bankers, ACB, and we are pleased to have this opportunity to discuss with the subcommittee recommendations to further reduce red tape on community banks. Our goal is that community banks will be able to better serve consumers and small businesses in their local markets. This hearing and this topic are important and timely.

Ten years ago, there were 12,000 banks in the United States. Today, there are only 9,000 of us left. ACB is concerned that community banks are significantly hindered in their ability to compete because of the cost of regulations. ACB has several recommendations to further reduce regulations on community banks that will help make doing business easier and less costly, further enabling community banks to help their communities prosper and create jobs.

First, ACB strongly supports passage of H.R. 3952, the Promoting Community Investment Act, sponsored by Congressman Jeb Hensarling. The bill will allow community banks with less than $1 billion in assets to participate in the Community Reinvestment Act small institution examination. By passing H.R. 3952, you will free up capital and other resources for almost 1,700 community banks across our nation, allowing them to invest even more into their local communities.

We believe that raising the threshold will reduce the regulatory burden for those institutions without diminishing the activities of

community banks or their CRA obligations. The goals of CRA are laudable and I take them seriously. But as a community banker, I would not be in business if I did not meet the credit needs of my community. And I do not need costly record keeping or a lengthy examination to tell me if I am doing the job.

Secondly, ACB supports passage of legislation to reform subchapter S of the Internal Revenue Code. Although not within the jurisdiction of this committee, we urge you to convey support to the leadership of the House Ways and Means Committee. The legislation should include several provisions: one, increase the number of shareholders of community banks who are eligible to form a subchapter S corporation from 75 to 200; two, permit IRAs to be eligible shareholders; three, clarify that interest on investments maintained by a bank to enhance safety and soundness is not disqualifying passive income; and four, permit bad debts to be charged off at the corporate level.

Because of recent false rhetoric, I hasten to add that the shareholders of subchapter S banks are fully taxed on their corporate profits. And speaking of taxes, I have to mention that a primary burden for many community banks today is that they pay taxes, but compete against a new breed of credit unions that do not. These credit unions function as full service banks wholly exempt from the taxes that we pay to support federal, state and local governments.

So the third way you can help community banks is to support Ways and Means Chairman Bill Thomas, who has proposed undertaking a review of the roles of tax-exempt institutions, and how they compete against for-profit companies. In my own state, Charter Oak Federal Credit Union is a $425 million institution that offers virtually every service my bank can provide. Their earnings last year were $4.6 million. They paid not a dime in taxes. Nothing. By simply calling themselves a credit union and requiring a $5 fee to become a member, they avoided paying over $1.5 million in income taxes.

In addition to paying taxes, bank-like credit unions should also be required to meet the same CRA requirements as banks. Credit unions that operate like banks should be treated like banks.

ACB's fourth recommendation is for Congress to make sure that Basel II and its attendant capital requirements do not put community banks at a competitive disadvantage with very large institutions. ACB believes that legislators, regulators and the industry should examine and evaluate the cost and complexity of the proposed Basel II capital accord.

We urge you to consider its competitive impact on banking institutions of different sizes, and the ability of regulators to properly supervise and examine the proposed new minimum capital requirements. Congress must make sure community banks across the country are not adversely affected by Basel II.

Finally, ACB urges you to review the rules that require community banks to send multiple privacy notices. Banks with limited information-sharing practices should be allowed to provide customers with an initial notice, and provide subsequent notices only when terms are modified. At my bank, we send out thousands of such notices each year at significant cost in both dollars and staff time,

even though our policies and procedures have remained consistent for many years. Redundancy in this case does not enhance consumer protection. Instead, it serves to numb our customers with volume. Let me be clear. We do agree a notice should be sent, but it becomes an expensive burden to send it multiple times. Once is enough.

On behalf of ACB, I want to thank you for your invitation to testify on the importance of cutting red tape for community banks. We strongly support the committee's efforts in providing regulatory relief. We look forward to working with you and your staff in crafting legislation to further accomplish this goal.

I will be happy to answer any questions you may have. Thank you.

[The prepared statement of Mark E. Macomber can be found on page 115 in the appendix.]

Chairman BACHUS. Thank you, Mr. Macomber.

At this time, we will be recessed until 1 o'clock. When we return, Ms. Kennedy you will be our first witness. Thank you.

[Recess.]

Mr. HENSARLING. [Presiding.] By Washington standards, to reconvene a 1 o'clock hearing at 1:15 is actually pretty good.

We will continue to await the return of Chairman Bachus. Until such time, I believe that, Ms. Kennedy, that we will have your testimony at this time. Thank you.

STATEMENT OF JUDITH A. KENNEDY, PRESIDENT AND CEO, NATIONAL ASSOCIATION OF AFFORDABLE HOUSING LENDERS

Ms. KENNEDY. I have been sitting here listening to the horror stories of the banks' encounters with the CRA exam, frustrated and angry that there have been many other bankers there before them who had the same bad experiences. But I am going to tell you that the National Association of Affordable Housing Lenders opposes an increase in the threshold for what is called the large bank exam.

I am going to ask you to think of it this way. There are not really tiers of regulation in this program. There is the so-called streamlined exam which really is about, are you lending in your community? What is the ratio of loans to your deposits. As one of these gentlemen said, at 70 percent, clearly he is lending in his community.

But the Community Reinvestment Act was about helping to meet the credit needs of your communities. It is crazy if regulations are forcing a bank that has no investment needs to invest in the community, but it is rational to say, how do we know that banks really are lending to low- and moderate-income people in their community or are investing in things that address the needs of folks in the community, including low and moderate income persons. Maybe it is Section 8 housing. Maybe it is tax credit housing. Maybe it is a homeless shelter. Maybe it is a financial literacy program.

But I think we have to stop and think, if 1,200 more banks are essentially exempt from having to invest in their communities and from having to document their loans to low- and moderate-income people, how could that play out in the various states?

Let's take Alabama as an example. Alabama currently has 35 insured depository institutions that are responsible for documenting

their loans and their services in low- and moderate-income communities, as well as making investments in those communities. If the regulators' proposal goes through to double the threshold to $500 million, Alabama will go from 35 covered institutions to 18. If the threshold is raised to $1 billion, Alabama will go from 35 today down to nine. I think we have to think about the practical effect of raising the threshold.

What is the practical effect of that? Again, the streamlined exam is you just prove you that you have made loans. I think the practical effect is that in Alabama, there will be at least $33 million less invested in affordable housing. It could be Section 8. It could be tax credits, homeless shelters, financial literacy. The practical effect of what the regulators have proposed is that going forward, only 12 percent of the insured depository institutions in this country will be responsible for documenting loans to low- and moderate-income folks and making investments. If the $1 billion threshold goes through, only 6 percent of the insured depository institutions in this country will have that responsibility.

The numbers are huge. Primarily, as you know, because HUD has very little money to spend, leveraging scarce Federal subsidy with private capital is critical. If the HUD budget is $31 billion, $19 billion of it goes for renewals of Section 8 voucher contracts. That leaves $12 billion for all the housing and community development needs of the country. Mid-size banks have been important contributors to housing and community development for low- and moderate-income families. I think we make a mistake if we think it is okay to simply wave a wand and say they do not have to demonstrate that anymore.

I think you will see significant declines nationwide, and I have given you some numbers on that. I think rural areas will be hardest hit for obvious reasons. And I will just add that the crisis in funding Section 8 where so many conventional lenders have reached out and made construction loans, but also mortgages for affordable rental housing in their communities, compounds all of the risk of taking this lending and investment out of low- and moderate-income communities.

Thanks for having me.

[The prepared statement of Judith A. Kennedy can be found on page 74 in the appendix.]

Mr. HENSARLING. Thank you, Ms. Kennedy.

Mr. Taylor, we will receive your testimony now.

STATEMENT OF JOHN TAYLOR, PRESIDENT AND CEO, NATIONAL COMMUNITY REINVESTMENT COALITION

Mr. TAYLOR. Good afternoon, Chairman Bachus, Acting Chairman Hensarling, and other members of this committee. Thank you very much for inviting me.

I am John Taylor, the President and CEO of the National Community Reinvestment Coalition which represents some 600 community organizations, faith-based organizations, local governments, and others who have asked us to come here today and give the community perspective on what regulatory relief of banks might mean.

Before I start, I want to say very clearly we love community banks. We have no axe to grind with community banks. So we are not starting from the premise that we are looking to do injury to them. We want them to prosper and do well.

I also want to point out that most of the members who have testified today on this panel who are from lending institutions are actually including your good friend, Mr. Hensarling from Texas, are actually already under the small bank test. So your relief would do nothing for that bank. With the exception of Long Island, the Smithtown Bank, which I think is over $600 million, which also the bank regulatory proposal would do nothing to impact their test.

What stimulates much of this hearing, of course, is the EGRPRA, the Economic Growth and Regulatory Paperwork Reduction Act of 1996, which asked regulators to eliminate any regulatory requirements that are outdated, unnecessary or unduly burdensome. I would like to go through that very quickly as it relates to CRA. Is CRA oversight outdated? Actually, no one's testimony suggests CRA is outdated. Indeed, the record shows many Americans have benefited from increased access to credit and capital since FIRREA and the establishment of clear tests under CRA lending serving investments.

In fact, the U.S. Treasury and Harvard University's Joint Center for Housing Studies have clearly shown in separate studies the impact of CRA and of the new CRA regulations. EGRPRA says eliminate unnecessary regulations. Again, there are few comments that these tests are in fact unnecessary. We know statistically that lenders who are tested under the three CRA-regulated tests are much more likely to serve low- and moderate-income borrowers. In fact, if you eliminate the service and the investment tests, we know that banks will have little or no obligation to maintain or even open branches in working class or working poor neighborhoods.

At a time in our history, ironically, where predatory lending has become a national shame, where America's most vulnerable who are elderly and others who are struggling for a better life are now having to turn to payday lenders and pawn shops and check cashing outlets for their basic banking services. In this era, we want to no longer test an additional 1,100 banks on their record of providing basic banking services to underserved people. It makes no sense whatsoever.

The Baker-Hensarling bill, H.R. 3952, would have the opposite impact implied in the bill's title, Promoting Community Investment Act. More accurately, H.R. 3952 should be called the Demoting Community Investment Act. This bill would remove 93 percent of all banks, 8,667 banks to be precise, from being tested on their record of providing basic banking services.

Similarly, the investment test, the third leg of the CRA regulatory exam, has proved very necessary, and has tremendous impact. One needs only to look to institutions that acted as intermediaries to assist lenders in making qualified CRA investments. Here, you find less than 10 percent of those who make investments are made by banks that are not tested for CRA investments. Estimates range up to over $50 billion investments in LMI areas that would be eliminated over time if the investment test no longer applied to banks with $1 billion or less in assets.

Finally, let us turn to the third EGRPRA threshold, to eliminate regulatory burdens that are unduly burdensome. Frankly, I have sat here through the hearings, the earlier testimony, and if you really look at the testimony and really listen to what people are saying, it sounds like there was an increase in regulatory burden, but it has nothing to do with CRA and everything to do with the PATRIOT Act, the Secrecy Act and a whole bunch of other things that have occurred.

In fact, what is interesting is, if you go back to 1990, CRA regulations, CRA reporting was number one on the list of lenders whenever they talked about regulatory burden. And now through various polls, whether you read American Banker, look at Mr. Reich's testimony and his studies, and you will find CRA has slipped to fifth place, a dubious honor and one that we are happy with, but one that should not be the basis for why there ought to be consideration of lessening the CRA application to financial institutions.

In any event, I want to wrap up because I see the light is on and I want to respect the time period. There is one thing I want to make a point of agreeing with my other panelists here, including the first panel. I think Mr. Macomber and others have made their comments in their testimony. There is an unlevel playing field when it comes to credit unions in this country. I am not talking about community development credit unions or the kind of singular company credit unions that only make loans to their employees. I am talking about these credit unions that basically say, our common charter is if you breathe, you can do business in our credit union; those ones that now have geographic distinctions that have no distinction between financial institutions.

My opinion is, if it quacks like a bank, it walks like a bank, it looks like a bank, and it acts like a bank, it ought to have the same obligations that other financial institutions have, and that is including the extension of CRA. So I would agree with the comments made earlier about that.

Mr. Chairman, thank you very much for your indulgence.

[The prepared statement of John Taylor can be found on page 192 in the appendix.]

Mr. HENSARLING. Thank you, Mr. Taylor.

Now, Mr. Hickman from Happy, Texas, please make us all happy.

[Laughter.]

STATEMENT OF J. PAT HICKMAN, CHAIRMAN AND CEO, HAPPY STATE BANK (TX) REPRESENTING INDEPENDENT BANKERS' ASSOCIATION OF TEXAS

Mr. HICKMAN. Thank you, Vice Chairman Hensarling.

My speech is written "Dear members of the committee," but it is you and me, Mr. Congressman. I hope the tape works well.

My name is J. Pat Hickman. I appreciate very much this opportunity to appear before the committee today on behalf of the Independent Bankers Association of Texas and the 550 banks that we represent throughout Texas. We thank you all very much for giving us this opportunity, this forum to come together and talk about a plot that is affecting our banks to a huge degree.

In addition to serving as the volunteer chairman of IBAT, I do have a day job. I am the chairman and chief executive officer of the Happy State Bank in Happy, Texas. Fourteen years ago I put together a group of investors that bought that little $10 million bank. Today, we are in eight communities, 11 different offices. We employ 130 people. We have $300 million in total assets. Of those eight communities, let me also add that four of those communities have less than 2,000 people. We are serving an underserved area. In two of our communities, we are the only financial institution in those communities.

In the 14 years that we have owned this bank, we have also written you a couple of checks. I went in and totaled it up the other day. Our little bank has paid $4.6 million in income taxes in the last 14 years that we have gotten to partner with you guys, and it is nice to come here and meet some of my silent partners that I am sending this money to.

[Laughter.]

I appreciate greatly your highways. I appreciate greatly the brave men and women who are taking care of us and protecting our security and our freedoms. I so appreciate the opportunities for life, liberty and the pursuit of happiness. You all have been great partners for the most part. But you have also been silent partners with some of my competitors. While you were doing some nice things for me, quite frankly you were doing some nice things for them. Quite frankly, you all have left community banks standing out in the cold. I do not think you have done it on purpose, but you have actually kicked us around pretty good. Just as a reminder in 1997, in H.R. 1151, you gave the credit unions these broad new common bonds, where as some of my former panelists have said, if you can breathe, you can join a credit union. They act like banks. They smell like banks. They quack like banks. They are banks.

In 1999, you passed the Gramm-Leach-Bliley Act giving the large mega-conglomerate banks all kinds of ways to make more money, but quite honestly there was not very much there for banks like the Happy State Bank. Just recently, the Federal Reserve Bank of Dallas completed a study that proved some things that community bankers have been talking about for years. This study shows, and I think this was pointed out earlier by Vice Chairman Reich, that in 1984 there were 11,000 banks under $1 billion. Today, there are less than 6,000 banks under that size.

When you have $1 trillion banks, I have a hard time deciding how someone can call a $1 billion bank a medium-size bank. Those are small banks when they get down under $1 billion that have been eliminated. Now, some folks would say that that is because I cannot compete. I do not know that it is so much that I cannot compete as much as it is that my silent partners have been taking good care of my competitors, have been taking better care of my competitors than they have been me.

I am not coming in here to ask you all to shut down the easy membership rules that the credit unions have, though there are some rather bizarre uses of those rules. I am asking you that if they look like banks, to tax them like banks. I am also not asking you to take away the expanded powers of the larger conglomerates, more power to them. But I am asking that you quit regulating me

like you regulate the conglomerates. Ease up some of the rules. I think that is what some of this hearing is about.

In Happy, Texas, I get excited when somebody walks in the door. We have 633 people there and we are investing in those people every day. Anybody that walks in the door, we are going to take care of them. That is what we do. Why am I paying the same FDIC insurance premiums that the megabanks pay? I do not own an insurance agency. I certainly do not own an insurance company or a securities firm. We are not investing in derivatives or underwriting proprietary mutual funds that we are going to try to hard sell to our own customers. I will never sell my customer's name to another company. Every time you call my office, I promise you a human being will answer the telephone.

That same Dallas Fed study that shows that we have 13 percent of the market showed two other things. I will wrap up here. It showed that 37 percent of the small business loans are being made by community banks. It showed that 61 percent of all agriculture loans were being made by community banks. We have 13 percent of the assets, but we are supporting the small businesses of this country that create the jobs, create the output, and the farmers that create the food.

My contention is, Mr. Chairman, that we are being regulated out of business. The trends that Vice Chairman Reich showed are trends that show we are disappearing. We would like you to please notice those trends and even that playing field some, and take care of the community banks that are so vital to this country.

Thank you all again very much for the time to make these comments.

[The prepared statement of J. Pat Hickman can be found on page 68 in the appendix.]

Mr. HENSARLING. Thank you, Mr. Hickman, for your testimony. If you spend a little bit more time with us, you may discover we are your partners, but we are not quite so silent.

As I look around the room, I think we will start the questioning with Chairman Baker.

[Laughter.]

Mr. BAKER. I am so glad you are in the chair. You are such a perceptive leader.

[Laughter.]

I want to thank each of you and regret the schedule has been prohibitively difficult today, and I have not been able to be here for your testimony, but have read each of your written statements. I want to explore briefly, but as thoroughly as we can, a remedy to the identifiable problems without centering on the issue of asset size. That is as unrelated as to what you do with credit extension as the number of parking spaces, in my view.

I would prefer to see us flip our current regulatory regime from a penalty box system to a reward system. Today, if you do not meet certain CRA requirements, then you cannot open a new branch or there are other penalties that are incurred. If you do comply, you get to pay off the bill for the compliance cost, but there is no other added benefit to the current process.

If, however, an institution were to engage in pre-described activities that were beneficial to the community, let's assume X percent

of loans are made within a 10-mile geographic radius of the institution, 50-plus; let's assume a certain percentage of loans are held in portfolio; a certain percentage of loans go to low-income people below a certain median income level in the community in which you are located; that a certain percentage of loans goes to small business enterprises.

As I have listened to the persuasive testimony of those engaged in the business practice, you describe activities that are centered on individual lending criteria and perspectives you have of that particular borrower, and not necessarily the hard bottom-line cash collateral associated with the request, although you do engage in safe and sound business practices.

My point is that if we were to proscribe, and I am not today saying we have such a screen, but glued together a number of issues that describe in the aggregate the conduct that we wish to incentivize, extending credit to the dairy farmer or to the dry cleaner who otherwise is not bankable somewhere else, and you do it within a geographic limit and you also help low-income individuals, and then as a result of that you are granted certain provisions of regulatory relief. We can talk then about what that list is and how we make it operative. If you drop the ball, then you go back into the pile again.

It would seem to me to be a reward for what we all hope is to be appropriate community involvement, whether it is rebuilding a school, helping low-income, providing financing for a water system. To that extent, we did expand the provisions of the federal home loan bank collateralization provisions to allow access for community banks to 15-year fixed-rate portfolio lenders, and there is no other source for that that I am aware of.

So despite our failure to cross the goal line on a number of other efforts, I do believe that is an essential partnering capability you do now enjoy that you have not had in the past. That may be worthy of exploration and further expansion.

I will start with you, Mr. Taylor, because I know we have discussed these issues in the past. I am coming at it in a slightly different way than in prior discussions. What is your initial reaction to that?

Mr. TAYLOR. I am intrigued, actually, except of course you have not used the word, that dirty word they do not like to use in this committee, called quotas, percentages of loans that currently the system does not have that. I have often wondered if we did, that communities might not be better served. Could the reward be that someone who really does that, if there were meaningful measurements that really showed, and the Community Reinvestment Act, as you know, is not about race or gender, but it is about income.

Unlike what Mr. Abernathy said, it is not just about serving the community credit needs; it is serving the community credit needs, and in the statute, including low- and moderate-income people. So if we had a measurement that could really measure that and showed a standard that was reasonable, to reward people down the line that perhaps their regulatory burden lessened, I think there is something to that. I hedge my comments on this, sir, by saying I do not think the regulatory burden right now on folks on the

banks who are here or those who are complaining has anything to do with the CRA, and everything to do with other regulations.

Mr. HENSARLING. But at least you have opened the door.

Mr. TAYLOR. Yes.

Mr. HENSARLING. Thank you.

Ms. KENNEDY. I think the burden is outrageous. I compare it in my own experience to what HUD was like in the late 1960s and the early 1970s where there were 600 questions and answers defining how you could spend federal funds. Congress threw all that out in 1974 and said, let's have a block grant. Well, these banks, some of them have charters from different agencies, and are dealing with the same crazy-quilt of questions and answers, but there is not one HUD; there are four of them. So this bank cannot get credit for doing something really incredibly creative, but the bank down the road can.

Having said that, what you describe, Mr. Baker, I think is very much possible under the current regulations. OTS Director Gilleran has actually been promoting it. It is called the strategic plan option. Some of the new entrants, such as a bank I was talking to last night that got a charter in Utah, chose the strategic plan option. Essentially, you come up with a menu of things, as you have described. You are subjected to public hearings. You get feedback from the community, and then you come up with a plan that your regulator thinks is appropriate to your share of the market, including low- and moderate-income people. So that option currently exists and maybe more institutions should and could take it.

Mr. BAKER. I can assure you I had no prior knowledge. This is not an act of plagiarism. It just seemed to be conceptually a reasonable screen through which we could conduct the public purpose.

If no one else, Mr. Chairman, I appreciate your courtesies in conducting this hearing and your leadership with the introduction of the bill. I really would like to see us at least have some conversation going forward about the elements that could be put into such a basket for review and then a secondary discussion about what does it mean to current program. But if you are meeting community need and you are at the same time losing customers to credit unions, losing the big borrowers to Wall Street, you have people buying their used car with a credit card, you have a diminishing number of bank customers, I think that is reflected not only as a result of mergers and acquisitions, but banks simply are choosing to do other things because the competitive market is so difficult.

I do believe at the margins in some instances the regulatory cost, which is estimated to be 13 percent of non-interest expense, is an element in whether a bank expands services or continues the fight. If we can do something at the margins that makes a competitive difference for these folks, I think it is in not only the community's, but the nation's best interest to do so.

Thank you, Mr. Chairman.

Mr. HENSARLING. Thank you, Mr. Chairman. And thank you for all your leadership on the issue of the regulatory burden and what you have done to help make the American financial services industry number one in the world.

I am not quite as studious and industrious as Chairman Baker. I did not quite read all of the testimony, but I read a lot of the tes-

timony. I noticed a provision of a sentence in your testimony, Mr. Taylor. If I can quote from it, "Without a comprehensive CRA, communities, particularly rural areas served by smaller banks, would suffer a new round of disinvestments, redlining and decay."

Mr. Goldston, let me start with you. Given that you are a community banker, and I am familiar with your community, what is going to happen to Forney, Texas and what is going to happen to Kaufman County if you did not have to fill out a comprehensive CRA exam?

Mr. GOLDSTON. The way we handle CRA, CRA is not the paperwork we do. Granted, we have a tremendous amount of paperwork associated with CRA. I remember when I was an examiner in the 1980s, one level of earnings that we looked to for banks was 1 percent. Whenever the information was given earlier, community banks were making .095, somewhere around there. Earnings have diminished, and at the same time our regulatory costs have increased.

When the cost of overhead, we look at loan losses, we look at all the costs associated with running the bank, I believe if we did not have to do all the paperwork, that we did not have to allocate all this money to doing things to say that we are providing service to our community, I think there would be a tremendous amount, more opportunities for us to take a chance on someone, for us to take a chance on businesses. I think it would help us grow the level of loans and to cater to different clienteles and do a better job of banking.

Mr. HENSARLING. Let me ask you about a provision in your testimony. I do not know if it came out in your oral testimony. You were alluding at one point to recent changes in regulation C concerning how you report home mortgage and home improvement loans that you are "charging an interest rate greater than 300 points above treasuries." And, "if we make a $5,000 five-year maturity home improvement loan, we cannot expend the time and paperwork to put that loan on our books, service it for five years, and only earn about $175 per year in interest. The intent is to disclose if we are engaging in predatory lending, but the result is to discourage us from making loans at all."

So are you telling us, then, that a regulation is actually de facto denying credit to low- and moderate-income people?

Mr. GOLDSTON. I believe that credit is denied to low- and moderate-income people because of the stack of paperwork that has to be done. By doing that, I say that whenever you look at the cost of that $5,000 home improvement loan, you are looking at drawing up the deed of trust, the notes. The costs associated with that sometimes are $1,000. To comply with all those regulations and all the disclosures we give, it is not practical for someone to come in and apply for that loan. So to say we deny them, no we do not, but I believe it is cost-prohibitive for those customers. A lot of times they may or may not have the $1,000 for all the closing costs associated with that to apply for the loan or to get the loan.

Mr. HENSARLING. Okay. Thank you. I also noticed, Mr. Taylor, in your written testimony that you say that most banks no longer complain about the regulatory burden of CRA. For those who rep-

resent banks that have to do the full CRA exam, do you consider it to be burdensome?

Mr. ROCK. Mr. Chairman, my bank is a $625 million bank, so we have been subjected to the large bank exam. We used to be examined under the streamlined exam. I am in Smithtown, Long Island, which is a suburban community about 50 miles outside of New York City. The first time that we were examined under the large bank exam, we were marked down because we had no loans to low-to moderate-income areas. My bank's market area extends for about 30 linear miles on Long Island and we have no, according to the U.S. Census Bureau, no low-to moderate-income areas in our market area.

So what we did to try to remedy that, because we wanted to be socially responsible, we do a lot of construction lending. So we looked for builders active in projects building low-to moderate-income housing outside of our market area. We made those loans to construct homes in low-to moderate-income areas outside our market area. The examiners came back and said we do not get credit for that because it is outside our market area.

So that is really the ultimate catch-22. If we make them in the market area, we cannot because there are no low to moderate, according to the government, in our market area. But if we make them outside the market area, we do not get credit for them. So we think that the objectives of CRA are laudatory and we agree with them, but I think that the issue is how is compliance with those objectives measured and administered. I think it is quite unfair to my bank and to banks of my size.

Mr. HENSARLING. Thank you.

I think that I will gavel myself down in respect to Chairman Bachus's time. Mr. Chairman, do you care to be recognized?

Chairman BACHUS. Thank you.

My first question, I will ask Mr. Leighty, maybe as a representative of the community banks, or Mr. Macomber, what is a community bank? Is there a definition?

Mr. LEIGHTY. I am not aware of a specific definition. I know when I started my banking career, a $50 million bank seemed big to me, because I was in a $25 million bank. I have contemporaries who are part of our association who run $1 billion banks, and they are clearly community-oriented banks. So I agree with some of the comments that have been made. It is not just a size issue.

I have heard it described as if they pose systemic risk to our economy, they are not a community bank. So our association is actually working on the very issue of defining what is a community bank. One thing I am sure, there are many banks that are above the threshold we talk about that are $500 million today, $250 million, $1 billion, that are very much community banks and are meeting the needs of their communities.

If I could, I would like to point out that the streamlined CRA, which our bank is small enough that we already qualify for the streamlined exam, I think it is important to point out that it shifts some of the burden to the examiners to determine if we are meeting the needs. But we are still required to meet needs in our geographic area, as well as to income levels. It does not allow us to

slide away from those responsibilities. It simply shifts the burden somewhat and makes the exam process more streamlined.

We believe that while we benefit from it, some of our brethren who are a little bigger than we are and maybe more the size that we would like to be, if we are successful and are able to grow and not become irrelevant as the markets may change, that it just makes sense to extend that streamlined process to some of the larger banks.

Chairman BACHUS. Mr. Macomber, would you like to comment?

Mr. MACOMBER. ICBA, ABA, and ACB are always trying to figure out what is a community bank, because we all represent community banks. I do not think that it is a function of size. I do not think it is a function of charter. I think it is a function of focus. The focus of my bank, as is true I think of everyone on this panel and most of the banks that are represented by the trade organizations represented here, their focus is very much on the communities they serve. We are not getting involved in esoteric things.

From a CRA perspective, good business for my bank; CRA takes care of itself. I do not turn down loans that are not good loans. I would not turn down loans that were good loans if I were a $300 million bank. Mr. Taylor noted that my bank does fall under the streamlined CRA regulations. However, my partner bank and the holding company is now considered a large bank for CRA purposes.

The way we function in the community is by and large the same. It has to be documented differently. There are more resources being devoted at that bank than at mine for things that are not necessarily helping the community. Those resources, in my opinion, many times could be better focused on doing the business of banking, and that is serving the credit needs of everyone in the community, low income on up.

Chairman BACHUS. All right. Mr. Taylor, I am going to ask you a different question. Do you operate a community bank?

Mr. TAYLOR. Do I operate a community bank?

Chairman BACHUS. Yes. I would rather ask people that have banks, as opposed to people who, you know.

Mr. TAYLOR. As opposed to consumer interests who want to respond to this stuff?

Chairman BACHUS. Yes. I am asking them what a consumer bank is.

Mr. TAYLOR. Okay. I cannot answer that, what a consumer bank is.

Chairman BACHUS. No, a community bank. I must have so many questions and so much time. I am going to ask you a question if I have time.

Mr. HICKMAN. Chairman Bachus, if I may, I would say one thing about community banks. You heard me state that I am in four communities with populations less than 2,000. In two of those, there are no other banks; there are no other credit unions. I am convinced that if I leave that community for any reason, no one else will go into that community. That almost to me defines community reinvestment. I am one of four businesses in Happy, Texas and I am under the threshold. The amount of time that me and my staff have to spend proving that we are serving our communities with a 95 percent loan-to-deposit ratio is ludicrous.

There are some things that common sense goes out the window, and I think this is one of those fair issues. If it smells like you are serving; if it looks like you are serving; you are serving. We do depend to a great degree also on what the regulators, their interpretation of serving the community is under that threshold.

Chairman BACHUS. Okay.

Mr. HICKMAN. It scares me to death, as I grow bigger, if that threshold does not go up.

Chairman BACHUS. All right. If I could have a few more minutes, since there is only the two of us.

Mr. HENSARLING. Absolutely, Mr. Chairman.

Chairman BACHUS. Mr. Taylor, I apologize to you. I want to hear your answer.

Mr. TAYLOR. Not necessary, sir. I listened to this gentleman from Happy, Texas. It makes me want to go visit Happy, Texas, to be honest with you.

Mr. HICKMAN. Come on.

[Laughter.]

Mr. TAYLOR. Would you make a loan?

Mr. HICKMAN. Sure.

Mr. TAYLOR. It would not count for CRA purposes. Although I did want to say to my friend from Long Island, if you meet the credit needs under CRA in your targeted assessment area and you make loans outside of it, you then get credit for it. If you have problems with the regulators getting credit, we will help you on that.

Mr. MACOMBER. I need you to come and help be my advocate.

Mr. TAYLOR. Absolutely.

Mr. MACOMBER. We have had two exams from the Federal Reserve and they tell me quite to the contrary, John. I think that is part of the problem. As I say, the issue is administration and testing of compliance. I think that is the issue. We have very fragmented administration of compliance right now.

Mr. TAYLOR. Got it. The point I wanted to make, Mr. Chairman, if I can get the balance of my time back.

Chairman BACHUS. You have it.

Mr. TAYLOR. When Mr. Goldston from Texas mentioned the stack of papers that they have to put together for loan closings, a tremendous amount of time and it is not worth it for these loans, there are actually no documents in there that relate to CRA. The fact of the matter is, if we really look at this hearing and listen to what the testimony has been, not just from this panel but from the previous panel, is there is an increased regulatory burden, but it has nothing to do with CRA and everything to do with the Privacy Act and the PATRIOT Act and the Bank Secrecy Act.

All the questions relate to CRA, from you folks and most of the comments respond to that because that is what is being asked. I am wondering why we are not asking questions about what happens to the 12 million reports that end up in Detroit in some basement of some building someplace that these banks are spending a tremendous amount of time filling out that information. What happens to all the other things that are occurring? We all want to fight terrorism. We all want to be patriotic. But is CRA going to be the fallout, a weakening of CRA? Is the CRA obligation going to be the

fallout under this PATRIOT Act and Secrecy Act? That is what strikes me as very odd about this.

Chairman BACHUS. I think that is a good point. I will just maybe close with this. That kind of brings to mind something that you were talking about, other than CRA. There was testimony I know from Mr. Macomber about Bill Thomas has some tax relief legislation. Ms. Kennedy, has your organization taken a look at that? I think it is in you all's best interest for these community banks to be strong and competitive. What about those?

Ms. KENNEDY. Of our 200-member organization, 70 of them are insured depository institutions and probably another 70 or 80 are nonprofit providers that work in communities like the Alabama Multi-Housing Consortium, from zero to $25 million in assets in 5 years, but only with investments from banks. We will look at it.

Mr. TAYLOR. I am with you on that and I am with the desire to look at nonprofit credit unions. I think you might have missed my comment earlier, a lengthy comment about the need to really look at the impact, particularly not so much obviously community development credit unions or the single-purpose company credit unions that only serve their employees, but the kind of credit unions that have grown into looking, acting, smelling and being just like any bank, but have tax exempt status, have FDIC insurance, and have no obligation under the CRA.

I should point out, when you look at their records of lending, these folks out-perform those credit unions in loaning to low- and moderate-income people and to people of color and to women, and that speaks very much to the fact that the fair housing laws and CRA, in fact, work because they are applied to these institutions.

So leveling the playing field, very much indeed I would agree, taking a strong look at those credit unions and seeing that they at least have the same obligation in those areas as our brothers and sisters here at the table who represent community banks.

Chairman BACHUS. I think that is a good place to stop, for everybody but one group.

Mr. HENSARLING. Thank you, Mr. Chairman. I am informed there is due to be markup here in this room in about 60 seconds. I want to thank the lady and all the gentlemen for their testimony. I note that we were joined by Mrs. Maloney.

The Chair notes that some members may have additional questions for this panel which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and place their responses in the record.

This hearing is adjourned.

[Whereupon, at 1:59 p.m., the subcommittee was adjourned.]

A P P E N D I X

May 12, 2004

STATEMENT OF CHAIRMAN SPENCER BACHUS SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT "CUTTING THROUGH THE RED TAPE: REGULATORY RELIEF FOR AMERICA'S COMMUNITY-BASED BANKS"

Good morning. The subcommittee will come to order. Today's hearing, which was requested by Congressman Hensarling, will focus on how to strengthen and preserve the important role that small banks serve in their communities, by reducing the burdens imposed on those institutions by outdated or unnecessary regulatory requirements. Among those testifying at the hearing will be Treasury Assistant Secretary Wayne Abernathy, Federal Deposit Insurance Corporation (FDIC) Vice Chairman John Reich, North Carolina Banking Commissioner Joseph A. Smith, Jr. on behalf of the Conference of State Banking Supervisors, and a number of industry and consumer group witnesses.

For generations, community-based banks have been the financial underpinning for millions of consumers, small businesses, family farms, local merchants, and rural economies throughout the United States. Community-based banks form the building blocks of our nation's communities by providing credit to all geographic regions of the country. They have contributed substantially to the stability and growth of each of the 50 states by facilitating a decentralized source of lending. This dispersion of our nation's assets and investments helps preserve the safety, soundness, fairness and stability of our entire financial system.

Community banks are often the linchpin to the survival and well-being of local communities, particularly small towns and rural America. They specialize in doing business in their respective cities and towns and reinvest their deposits into their communities through local lending. Currently, more than 8,700 community banks with

almost $2.3 trillion in assets continue in the tradition of giving back to their local communities through nearly 40,000 banking offices. Annually, community banks have made more than 3 billion loans to small businesses, totaling over $275 billion and 720,500 loans to small farms, totaling more than $37 billion.

Recently I introduced House Resolution 591 which recognizes the importance of small banks in developing our communities and the Nation as a whole and designates April as "Community Banking Month." I am hopeful that this legislation will be considered on the House Floor soon.

Although small banks have been prosperous in recent years, they face a disproportionate regulatory burden in relation to their large bank counterparts. When a new regulation is created or an old regulation is changed, small institutions must devote a large percentage of their staff's time to review the regulation to determine if and how it will affect them. In addition, compliance with a regulation can take large amounts of time that cannot be devoted to serving customers or business planning. Easing the regulatory burdens on small banks frees up more of those banks' resources for loans to small business and other credit worthy borrowers, helping to promote economic growth and greater consumer choice.

In closing, I would like to thank Mr. Hensarling for working with us on this hearing. Congressman Hensarling recently introduced H.R. 3952, the Promoting Community Investment Act, which would require the banking regulators to give banks with less than $1 billion in assets the streamlined exam for compliance with the Community Reinvestment Act (CRA). Currently, streamlined CRA exams are limited to

banks with less than $250 million in assets. This is just one example of Mr. Hensarling's strong commitment to issues affecting community banks.

The chair now recognizes the Ranking Member of the Subcommittee, Mr. Sanders, for any opening statement that he would like to make.

Prepared, not delivered

Opening Statement

Chairman Michael G. Oxley

Committee on Financial Services

Subcommittee on Financial Institutions and Consumer Credit

Hearing on "Cutting Through the Red Tape: Regulatory Relief for America's Community-Based Banks"
May 12, 2004

Thank you, Chairman Bachus, for holding this hearing on relieving the regulatory burdens faced by America's small community banks.

The economic vitality of Main Street, U.S.A. is critically dependent on the existence of a robust community banking sector capable of delivering financial products and services tailored to meet local needs. To cite just one example, small businesses, which are the primary engines of job creation in our economy, rely heavily upon community banks for their financing.

A recent study by economists at the Federal Reserve Bank of Dallas found that small banks – defined for purposes of the Fed study as holding assets of less than $1 billion – account for some 37 percent of total bank lending to small businesses, even though those same banks control just 13 percent of total banking system assets.

For small banks to continue to serve their historic role as a financial lifeline for local communities, they must be free to operate in a regulatory environment that does not shackle them with overly burdensome requirements. That is why this Committee has – in each of the last two Congresses – made regulatory relief for the financial services industry one of our highest legislative priorities. Earlier this year, the House passed, by a vote of 392-25, comprehensive regulatory relief legislation that originated in this subcommittee.

The legislation, authored by the gentlelady from West Virginia, Mrs. Capito, and reflecting contributions from many Members of the Committee on both sides of the aisle, contained several provisions targeted at the small community banks that are the focus of today's hearing, including measures to make it easier for such institutions to qualify for tax-favored treatment as Subchapter S or limited liability corporations.

While no companion bill has yet been introduced in the other body, I hope that we can get Mrs. Capito's legislation to the President's desk this year. Another bill that awaits Senate action – and that has enthusiastic support from community bankers across America – is Chairman Bachus' deposit insurance reform legislation, which passed the House with more than 400 votes last year.

Community bankers know firsthand the role that a strong deposit insurance safety net plays in ensuring the stability of the banking system and in encouraging America's savers and depositors to entrust that system with their hard-earned dollars. I once again call upon our colleagues in the Senate to act on deposit insurance reform legislation this year.

All of us recognize that regulatory oversight intended to preserve the safety and soundness of our nation's banks and to protect consumers against abusive and unfair practices is essential, and no one is here to suggest that any of those basic safeguards be dismantled. Indeed, where necessary to confront pressing national challenges, this Committee has not hesitated to **increase** the regulatory burden on banks and other depository institutions, in areas such as terrorist financing, through the USA PATRIOT Act, and identity theft, in the recently enacted FACT Act.

In doing so, however, we have tried to be sensitive to the additional compliance burdens being placed on financial institutions, and have been particularly careful to avoid imposing "one-size-fits-all" regulatory approaches that fail to distinguish among institutions with vastly different risk profiles and business models. Simply put, it is both a misallocation of regulatory resources and a disservice to small banks and their customers to expect those institutions to bear the same compliance costs as large, multi-national banks with complex assets and huge transaction volumes.

Although it does not happen nearly often enough, recently, the Federal banking agencies took an important step toward relieving the regulatory burden on small banks, by proposing to increase the asset size limit for banks to qualify for streamlined Community Reinvestment Act (CRA) exams from $250 million to $500 million.

I commend Vice Chairman Reich and his fellow regulators for this long overdue update to CRA. I also urge them to consider incorporating in their final regulation the approach taken in legislation introduced by the gentleman from Texas, Mr. Hensarling, and other Members of this Committee, which would raise the small-bank exam threshold even further, to $1 billion.

Thank you again, Chairman Bachus, for convening this important hearing. I look forward to the testimony of all of our witnesses.

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Representative Jeb Hensarling
Opening Statement for Financial Services Hearing
"Cutting Through the Red Tape: Regulatory Relief for America's Community-Based Banks"
Wednesday, May 12, 2004

Thank you Mr. Chairman, and thank you for holding this very important hearing. Nearly every community throughout America is served by at least one small, locally-based, usually locally owned bank which focuses on meeting the financial needs of the consumers living and working within the community. They are built on personal contact, community ties and close lender-borrower relationships. They are often the economic lifeblood of rural America. Chairman Alan Greenspan has called them "one of the jewels of the international financial system" because of their uniqueness. They are our nation's community banks.

They create jobs, hope and opportunity but they are threatened. In 1984 we had approximately 11,000 community banks – today the number is roughly half that.

One has to ask why? If banking customers within a competitive marketplace are simply deciding they no longer want or need community banks, then we should not interfere. However, I fear it is our interference in the first place which is helping cause the phenomena.

When you ask community bankers what is the main obstacle they face in surviving and thriving, the answer is almost always the same: Overly burdensome, costly and time-consuming federal regulations. Currency Transaction Reports, Know Your Customer requirements, Reg. D, Reg. C, Community Reinvestment Act, Privacy Act Notices, Reg. Z, and the list goes on and on and on.

The federal regulatory burden on smaller banks can many times be significantly disproportionate to their larger counterparts, especially for institutions with branches located in rural and more scarcely populated areas. This is mainly because compliance costs for banks of all sizes contain a significant fixed cost component that all banks have to pay. These fixed costs will come out of a much smaller revenue base in a small bank. Larger regional or national banks can spread the costs out over a much larger revenue base.

I am convinced that more action is needed to remove some of the restrictions on community banks, and permit them to operate in a manner that preserves more resources for creating jobs, saving farms, and serving their communities.

When bankers are telling me that they can spend $300,000 per year on non safety and soundness compliance alone, it is time to take a hard look at the regulatory burden placed on our banks.

When I am hearing that two-thirds of many bank's total compliance costs are not even related to the safety and soundness of the institution, it is time to take a hard look at the regulatory burden placed on our banks.

When community bank employees are spending more than 31,000 hours per year on compliance matters alone, it is time to take a hard look at the regulatory burden placed on our banks.

When approximately 1 out of every 4 dollars goes to regulatory compliance for the average small bank, it is time to take a hard look at the regulatory burden placed on our banks.

That is why I believe it is imperative that Congress continue to examine the regulations banks are forced to comply with, and act to remove or restructure antiquated and outdated regulations that stifle lending opportunities for banks working to serve their communities.

In many cases, the most burdensome of these regulations stem from the Community Reinvestment Act, or CRA. I have introduced legislation to allow banks with less than $1 billion in assets to participate in a streamlined "small bank" CRA exam. In defining a small bank $1 billion in assets is the industry standard and is the cut off for the Federal Reserve as well.

My bill, the Promoting Community Investment Act, would provide regulatory relief for more than 1,600 banks serving communities throughout the nation. Although it is important to note that 85% of industry assets would still be subject to the large bank CRA test.

The Congressional Research Service reports that a streamlined CRA exam can save a bank 40% in compliance costs. Even still, it is estimated that banks under the CRA's current $250 million small bank threshold spend more than $80,000 a year on CRA compliance alone!

While many groups continue to argue that a large bank CRA exam is practical for small banks, I disagree:

American consumers of all income levels have access today to the lowest cost and most readily available credit in the world. This pro-consumer phenomenon is not a result of any federal statute, rule or regulation. This is a result of American productivity and innovation, coupled with the consumer friendly benefits that a competitive marketplace provides.

A final point I would like to make is that capitalism does not work without capital. Congress should be in search of ways to free up more capital for our local lenders, not tie their hands with more regulation and red tape. Allowing a streamlined CRA exam for these smaller institutions would be just one way to do just that.

I look forward to working with Chairman Bachus, Chairman Oxley, and Chairman Baker, as well as other members of this committee to address these issues.

**OPENING REMARKS OF THE HONORABLE RUBÉN HINOJOSA
HOUSE FINANCIAL SERVICES COMMITTEE
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
"CUTTING THROUGH THE RED TAPE: REGULATORY RELIEF FOR COMMUNITY-BASED BANKS"
MARCH 30, 2004**

Chairman Bachus and Ranking Member Sanders,

I want to thank you for recognizing me and for calling this hearing today.

A number of today's witnesses are going to testify about the important role community banks play for their customers as well as their communities.

Mr. Chairman, Assistant Secretary Abernathy stresses in his testimony that community banks are known for their "neighborliness." Knowing several community bankers personally, I concur with this characterization. I also agree with him and with other witnesses who believe that community banks provide financial services to all kinds of small businesses and to other customers that normally might be overlooked.

What I found interesting in his testimony is that Mr. Abernathy references data from the FDIC but draws a different conclusion than FDIC Vice Chairman Reich as to whether community banks need regulatory relief. Mr. Abernathy contends that any regulatory relief should recognize the dual banking system and provide equal regulatory relief to both large and small banks and other institutions. Vice Chairman Reich contends that community banks are operating at a lower level of profitability than the largest banks in the country, in part due to the "disproportionate impact that regulations" have on community banks. Unlike Mr. Abernathy, Mr. Reich argues that the future of community banking depends on providing them, and not the larger banks or credit unions, with regulatory relief. In fact, he contends in his testimony that "credit unions operate with a number of advantages over banks and thrifts," and he states that Congress should "reexamine and seek to resolve" these disparities.

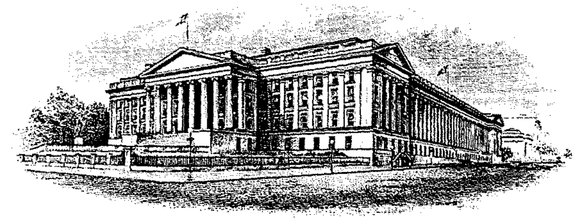
Obviously, these two statements seem to be in direct conflict, and I wonder which one bests describes the current situation.

The question becomes whether community banks are truly not on a competitive level playing field with their counterparts.

At present, I am reviewing Mr. Hensarling's legislation, H.R. 3952, the "Promoting Community Reinvestment Act," which would allow community banks with less than $1 billion in assets to participate in a small institution examination. I want to determine if this legislation is the appropriate regulatory relief to consider at this time, or if we should wait until the regulators complete their regulatory review.

I am also reviewing the Independent Bankers Association of Texas's idea for a community bank charter.

Mr. Chairman, I yield back the remainder of my time.



DEPARTMENT OF THE TREASURY
OFFICE OF PUBLIC AFFAIRS

EMBARGOED FOR 10:00 am EST
May 12, 2004

Contact: Anne Womack Kolton
202/622-2960

Testimony of
Wayne A. Abernathy
Assistant Secretary for Financial Institutions
Department of the Treasury
Before the
Subcommittee on Financial Institutions and Consumer Credit
of the
Committee on Financial Services
United States House of Representatives

Chairman Bachus, Ranking Member Sanders, and Members of the Financial Institutions and Consumer Credit Subcommittee, I would like to thank you for this opportunity to testify on the regulatory burden faced by the nation's community banking institutions.

Small banks and thrifts provide households and small businesses services that are greatly valued by the communities in which they are located, particularly for the continuity of service that they present as well as for their close association with customers and the local community, what might even be called neighborliness. Their longstanding focus on individual customer relationships and in-depth knowledge of local area credit needs serve our nation's communities well. Of particular importance in achieving major goals set for us by President Bush, community banks' expertise in local area relationship lending enables them to provide financial services to various kinds of small businesses and hard-to-reach customers that might otherwise be overlooked.

Industry Consolidation and Small Banking Institutions

Undeniably, the U.S. banking industry has experienced significant consolidation in recent years. The 25 largest banking organizations accounted for 58 percent of all bank and thrift assets at the end of 2003, up from 39 percent 10 years earlier. If we chose $1 billion in assets as the dividing line today between small banks and medium and large banks, the total number of small banks and thrifts—those with assets under $1 billion—declined from 12,664 at year-end 1993 to 8,601 at year-end 2003, a decline of almost one third over the past 10 years. A substantial majority of

banking acquisitions in the last decade has involved banks with under $1 billion in assets. Some have raised concerns about what these trends may mean for the future of community banking.

And there might be cause for alarm if we looked no further. Fortunately, chartering activity in recent years demonstrates the vitality and attractiveness of community banking. According to the Federal Deposit Insurance Corporation (FDIC), there were over 1,200 new community banks and thrifts established since the beginning of 1992. After accounting for mergers, acquisitions, and only 4 failures, almost 1,100 of these institutions continue to serve their communities today.

The profitability of small banks and thrifts has been relatively stable over the past decade, as measured both by return on assets and return on equity. Of some interest, however, larger banks have expanded their profitability in recent years. In 2003, small banks and thrifts achieved a return on assets averaging 1.14 percent, while those institutions exceeding $1 billion in assets averaged 1.42 percent. Similarly, return on equity was 11.12 percent for small banks, compared to 15.85 percent for those exceeding $1 billion in assets. In contrast, for 1993, the measures of return on assets for small and large institutions were virtually identical, while large institution return on equity exceeded that of small institutions only by about half the difference observed in 2003.

A large part of the reason for this difference may be a good news story: the capital position of small banks is strong. So it is a matter of math: small depository institutions have lower returns on equity than larger institutions in part because they have more equity relative to their assets; that is to say, small banks operate with larger capital cushions than do larger banks. At year-end 2003, small banks and thrifts had an average core capital ratio of almost 9.8 percent – almost twice the amount required for "well-capitalized" status and more than 2 percentage points higher than the average core capital ratio for larger institutions. Strong capital levels empower small banks to meet the particular—and often unique—credit needs of the household and small business borrowers in their communities, while at the same time preserving banking system safety and soundness.

Burden of Regulation on Small Banking Institutions

While we have great confidence in the strength and vitality of small banks and thrifts, their prosperity should not be taken for granted. They continue to face challenges from a variety of sources. A significant challenge to small banking institutions arises from the burden that regulations impose on their ability to compete effectively with larger bank and nonbank companies. Many regulatory requirements impose some degree of fixed costs, but these can weigh more heavily upon the comparatively smaller revenue base of community banks.

This is not a new observation. To try to compensate for this imbalance, many of our laws, regulations, and supervisory practices take into account differences between smaller and larger banking institutions in ways that help to mitigate potential competitive disadvantages for smaller institutions. For example:

- The size and complexity of the largest banking organizations require teams of federal examiners in residence year-round, while examiners visit smaller institutions only on a periodic basis.

- Smaller and less complex institutions generally have somewhat less detailed regulatory financial reporting requirements.
- Under current rules, banks and thrifts that have less than $250 million in assets and are not part of holding companies with banking assets exceeding $1 billion are subject to a streamlined Community Reinvestment Act (CRA) test.
- Smaller depository institutions have more liberal access to Federal Home Loan Bank advances (i.e., with respect to asset portfolio composition and eligible collateral) than do larger institutions.
- At year-end 2003, 2,019 small banks and thrifts received the benefits of Subchapter S corporation tax treatment, up from 604 institutions at year-end 1997.

Reducing Regulatory Burden

Still, we believe that more can and should be done to reduce burdensome regulations on our financial institutions, particularly community banking institutions, without compromising their prudential operations. As I mentioned, we are heartened by the fact that there continues to be an interest in new community bank charters. Ease of entry is a sign of the competitiveness of markets. We must be careful that regulation does not create a significant barrier to the entry of new banking firms and reduce competition among financial services providers.

In 1996, Congress passed the Economic Growth and Paperwork Reduction Act, requiring the banking regulatory agencies to identify statutory provisions and regulations that are outdated, unnecessary, or unduly burdensome, and seek public comment as part of this process. The agencies were then to take steps to reduce such burdens through rulemaking or recommend that Congress enact appropriate legislative changes.

This directive was reinforced by a recent call by President Bush that we should be sure that all federal, state, and local regulations are absolutely necessary. An interagency task force, under the direction of FDIC Vice Chairman John Reich, has taken on this important task. To begin, they grouped banking regulations into 12 categories. Last summer, the agencies published the first of a series of notices, seeking feedback from the public on three of the 12 regulatory groups: applications and reporting, powers and activities, and international operations. In January of this year, the second notice was published, requesting comment on consumer protection lending-related regulations. This careful and comprehensive approach to the review of regulations could prove fruitful in identifying ways to reduce compliance burdens on banks, especially on small banks, while also relieving corresponding strains on supervisory resources, without sacrificing important supervisory objectives.

Earlier this year, the banking agencies also issued a proposed rule that would make more community banks eligible for a streamlined CRA examination. Institutions with under $500 million in assets, rather than $250 million under current rules, would be eligible for the streamlined test. Furthermore, under the proposal, a bank or thrift meeting the small institution threshold size would no longer be subject to the CRA large bank retail test (which includes investment and service components) simply because it is part of a holding company having over $1 billion in banking assets. The agencies estimate that the proposal would cut in half (to about 11 percent of all banks and thrifts) the number of institutions subject to the large retail institution test.

Congress has joined this regulatory relief effort as well, moving forward several items of legislation to improve the competitive position of the community banking system. For example, the Treasury Department has consistently supported legislative proposals to repeal the prohibition on paying interest on demand deposits. The House of Representatives has several times passed legislation that included this repeal. Repeal of the prohibition on paying interest on demand deposits would eliminate a needless government price control and increase economic efficiency. Community banks with fewer means to maneuver around the current restrictions would be better able to compete with large banks and nonbank financial services providers in attracting business depositors. And repeal would benefit the nation's small businesses by allowing them to earn a positive return on their transaction balances. Larger businesses and larger banks today have been able to offset the lack of interest on checking accounts by using sweep accounts to earn interest or by including price concessions in other bank products.

Conclusion

Few observers would dispute that depository institutions of all sizes face a heavy regulatory burden, and that this burden falls disproportionately on the nation's small banks and thrifts. The costs of regulatory compliance are significant, and include not only burdens directly imposed on the industry, but higher levels of supervisory expenses that are ultimately passed on to banks, consumers, and taxpayers. When regulatory burdens are excessive and fail to add net value, they take a toll on the competitiveness of our financial system and on overall economic efficiency. The Treasury Department encourages efforts by the banking agencies to reduce regulatory burdens on banks of all sizes, an effort that is likely to benefit community banks and their customers in particular, and we stand ready to work with Congress to further these objectives.

Many have commented on the tremendous benefits we derive from our great dual banking system. When they do so, they usually refer to the dual system of state and national bank charters. But I think that we should include in that concept, as a sign of the great health and strength of our financial system, a vibrant, competitive array of banks of all sizes meeting the financial needs of our businesses and communities—which also come in all sizes, large and small. That is not only something worth preserving—it is something worth promoting.

TESTIMONY OF

Jim Goldston

before the

**SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT
COMMITTEE ON FINANCIAL SERVICES
UNITED STATES HOUSE OF REPRESENTATIVES**

May 12, 2004

Mr. Chairman and members of the committee, I am honored to appear before you today to discuss the importance of community banks to our nation and to ask for your help in reducing unnecessary and burdensome regulations. My name is Jim Goldston and I live and work in Forney, Texas, a small town just east of Dallas. Congressman Jeb Hensarling will soon represent our community and I am here today at his invitation.

I have worked in banking for over 20 years, and for the last five years, I have been a branch president for City Bank (and that is C I T Y, not C I T I), first in the West Texas town of Morton and now in Forney. But for three of those years I was a bank examiner for the Texas Department of Banking. During that time, I observed many banks, both good and bad, and gained some understanding of how state and federal regulations can and should improve the safety and performance of our banking system to benefit and protect both our customers and our FDIC deposit insurance structure. I am not here today to ask you to significantly alter our dual banking system or its regulatory structure in which the Federal Reserve System, the OCC, the FDIC and the state banking departments all have important roles to play. I am also not asking that major legislation such as the Community Reinvestment Act or the Patriot Act be repealed. I only want to

over \$565,000 to our internal compliance and audit staff and over \$160,000 to outside firms just to be sure that we were complying with those regulations and policies. These figures do not include the expense for our other employees' time spent actually complying with those regulations; it is only what we spent just training them and checking to be sure that they did. It also does not include the cost of the time spent by our state and federal regulators checking up on our "checking up."

Let me give you a few examples of the sort of regulations that frustrate and burden community banks. Recent changes in Regulation C are more burdensome than helpful. We are now required to report home mortgage and home improvement loans on which we charge an interest rate greater than 300 points above the rate for a Treasury bond of comparable maturity. The current interest rate environment makes that target unrealistically low. If we make a \$5,000.00, five-year maturity home improvement loan, we cannot expend the time and paperwork to put that loan on our books, service it for five years and only earn about \$175.00 per year in interest. The intent is to disclose if we are engaging in predatory lending, but the result is to discourage us from making the loans at all. Bankers never, ever waive red flags at our regulators if we can help it.

Everyone is being encouraged to shop for the best deal when seeking a home mortgage loan, but this shopping may be distorting the data flowing from our Home Mortgage Disclosure Act (HMDA) logs. We are required to record all significant aspects such as loan amount, income of borrower, ethnicity, rate spread, purpose of loan, and other data on each loan application we receive, whether or not we make the loan. Every bank that the customer shops must spend the time to do this, but only one will report the originated loan. Everyone else's log will look like they turned the loan down.

they must sign in order to close the loan. Candidly, they don't take the time to read the items they are signing. The volume is just too intimidating, and the disclosures don't always provide the data that the customer wants. Yet, virtually every disclosure we provide is statutorily prescribed. Rather than help customers make good choices, the absurd proliferation of disclosures simply frustrates every one involved in the mortgage lending process.

The current rigid guidance makes banks that are serving low and moderate income neighborhoods into "sub prime banks" with increased capital requirements. While banks that buy risky, sub prime portfolios need additional scrutiny and capital, strict application of these rules is making it difficult for community banks to serve their real communities.

Finally, the expansion of the "small bank" classification for CRA rules has greatly helped many community banks, but many of us are still caught in a web of trying to comply with rules for advanced testing designed for massive, complex, nationwide organizations that bear little resemblance to even the biggest community banks.

The current review of banking regulations taking place under the Economic Growth, Recovery, and Paperwork Reduction Act (EGRPRA) is a good start on seriously reviewing regulatory burden, but it must be coupled with statutory change as well. Many of the burdensome requirements described above are not a matter of regulation but rather are mandated by statute. We community bankers implore you to seriously take up reduction of regulatory burden.

As a community banker, I, like my peers, want to serve my community with reasonably priced products—home loans, small business loans, agriculture loans and

TESTIMONY OF

J. PAT HICKMAN

on behalf of

THE INDEPENDENT BANKERS ASSOCIATION OF TEXAS (IBAT)

before the

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT COMMITTEE ON FINANCIAL SERVICES UNITED STATES HOUSE OF REPRESENTATIVES

May 12, 2004

Chairman Bachus and members of the Committee, my name is J. Pat Hickman. I appreciate the opportunity to appear before this Committee today on behalf of the Independent Bankers Association of Texas and the roughly 550 community banks across Texas that we represent to share our perspective on this important sector of the financial services industry. In addition to serving as the Chairman of the Independent Bankers Association of Texas, I am Chairman and CEO of the Happy State Bank, a $290 million, locally owned institution with a staff of 130. Happy State Bank now has 11 offices serving 8 communities in the panhandle area of Texas.

IBAT would like to publicly express our appreciation to Chairman Bachus for calling this hearing, as well as Congressman Hensarling for his efforts to provide for a forum to discuss some of the pressing issues facing our industry.

In the fall of 1996, various groups representing small, community based banks began crafting a plan to ensure the continued survival and competitive standing of the community bank. Given the inevitability of Glass Steagall reform/repeal, diminution of the market share of commercial banking in the financial services arena and a highly aggressive credit union industry, it was clear that enhancements to the community bank charter would be necessary to allow for some semblance of competitive equity.

The original proposal contemplated a scenario in which the community banks who were operating in accordance with their charter, and appropriately serving their communities, would be the beneficiaries of favored tax status which would provide some level of parity with the credit unions with whom they compete. Additionally, a framework was provided which would have allowed credit unions to operate and grow without opening the common bond to the extent of making any exclusivity in membership a thing of the past.

In other words, those entities doing the same banking functions for the same clientele would be treated - and taxed - with some level of consistency. With the credit union industry now able to compete directly with community banks on a fully tax-exempt basis, the future viability of community banking is clearly in jeopardy. In a post - H. R. 1151 world, this proposal – or something similar - takes on more significance and urgency.

With the enactment of the "Gramm-Leach-Bliley Act" (GLBA) in the fall of 1999, community banks face additional challenges in their quest to provide competitive products and services to their respective markets. While clearly necessary from a public policy perspective, we believe this law allows more efficient access to new markets for larger financial conglomerates, and will almost certainly accelerate both intra- and inter-industry mergers.

Although credit unions and community banks may compete for customers, it is extremely important that there remain an incentive for both to compete in underserved and marginal communities that the large financial institutions have historically ignored. This becomes more significant with the continued proliferation of merger activities among the financial services giants. With the passage of the far-reaching credit union legislation in the 105th Congress, credit unions have been able to grow aggressively and serve virtually anyone. In this environment, these institutions will enjoy the competitive advantages of any large conglomerate financial institution, but will have the added benefit of being both tax-exempt as well as exempt from much of the regulatory burden faced by our institutions.

The entrepreneurial capital and oversight provided by our shareholders is key to prudent credit and pricing decisions, efficient operations, and a long term view of the importance of fostering economic growth and development in the community. The community bank has always played a key role in the overall health and vitality in a multitude of communities across the nation – the extinction of this industry due to legislative mandate would be a significant loss to our economic system.

The Federal Reserve Bank of Dallas, in the January/February 2004 issue of Southwest Economy, published a study entitled "Small Banks' Competitors Loom Large". Among the many salient observations in this study is the market share analysis. Small banks (assets less than $1 billion in this study) have declined substantially in number and market share. In 1984, there were over 11,000 of these entities. By mid-2003, that number had declined to about 6000. These small banks controlled 23% of the banking market in 1984, and by 2003 represented some 13% of the market. Large banks (assets greater than $25 billion) increased their portion of the market from 42% in 1984 to 71% in 2003. This represents a dramatic shift toward large banking conglomerates, and as we all are aware, the consolidation and concentration within our industry continues.

The study also found that credit union assets (adjusted for inflation) have more than tripled during the study period from $194 billion to $611 billion, while small bank assets have actually decreased. If adjustments are made to include those small banks that grew into the midsize group ($1 billion to $25 billion), then this portion of the industry has reflected an 80% growth rate. This appears impressive as a stand-alone statistic, but is still dwarfed by the 200% growth in the credit union industry. A similar analysis we commissioned several years ago also reflects a disproportionate and rapid rate of growth in those credit unions in excess of $1 billion in assets.

The Federal Reserve Study also revealed that small banks have lagged far behind both large banks and credit unions in key areas such as asset growth, loan growth and deposit growth. Perhaps most troubling is the fact that the study showed that the profitability of small banks has been lagging far behind their competitors. These key indicators confirm the trend that was first revealed in a Veribanc study that our association commissioned in 1999. Both studies are consistent in their conclusion that in virtually every area of banking activity, small banks are under immediate and serious threat.

Why should this committee be concerned about these trends? The answer is because of the economic consequences if this pattern continues and because you can do something about this. Consider the Fed study also revealed that, despite the incredible asset growth by larger institutions, small banks' share of bank lending to small businesses has slipped only from 40% to 37% in the past ten years. This is particularly remarkable given the fact that small banks control only 13% of the banking system assets.

Let me remind everyone that small businesses account for over 50% of the private sector output and employment, approximately 70% of the net job growth, and they provide the majority of American exports to other countries. The problem is there are fewer small banks to make these loans and a there is a declining percentage of the banking system inclined to make such loans. We don't think we are over-reacting when we state that the continued shrinkage of a viable, vibrant small banking industry threatens this fundamental economic base and the overall health of the domestic economy.

Similar statistics and patterns exist when one examines the relationship between small banks and agriculture. The Fed study confirmed that small banks, as a sector, make 64% of the bank loans made to farming operations. Like small businesses, small banks have unique relationships and understanding of the agricultural lending industry. If we think the family farmer is important, consider that small banks make the overwhelming majority of farm real estate and farm operations loans of $100,000 or less. This component of the U.S. economic base will be similarly impacted by the continued decline of small banks.

Mr. Chairman, we are not fabricating these statistics. We now have two studies that confirm these trends and the losses that small banks are experiencing. Unless we take immediate steps to help us remain relevant and competitive, the small business component of the U.S. economic system is threatened. It is not the marketplace that has negatively impacted our competitiveness, but rather a series of regulatory and statutory requirements promulgated by our Federal government that has created this dilemma.

IBAT has been working on several legislative initiatives at the federal level over the course of several years. One such initiative is "The Community Savings and Investment Act". We appreciate the efforts of the lead sponsors, Congressman Pete Sessions (H.R. 2341) and Senator Kay Bailey Hutchison (S. 2220), along with a significant number of other Members and staff who have supported this initiative. The basis of this initiative is to provide community banks with some level of parity with its tax-exempt competition, recognizing that there is a public need for the benefits our industry provides. Additionally, there are specific tax benefits for those institutions domiciled in and serving bona fide underserved areas, which in our assessment, would create significant economic opportunities and needed stimulus in these areas.

As we met with members of Congress and their staffs, along with other key regulatory and agency personnel, it became clear to us that this initiative should be broadened to recognize the bifurcated banking industry that has evolved, along with the dramatically changing credit union competition. We are in the process of working toward the introduction of legislation that will create a new charter – or at the least recognize and treat community banks differently than the regional, national and global financial services conglomerates. Additionally, if Congress continues to allow the unfettered expansion and growth of community and "sham" common bond credit unions, we believe that substantive changes must be made in the way we as an industry are regulated and taxed.

The "Community Bank Charter" (CBC) concept effectively brings us full circle from where we began in 1996 with the impending passage of H.R. 1151 and what ultimately became GLBA. We believe that the basic components for discussion are as follows:

Powers. Community banks provide "core" banking services – lending and deposit functions – as well as retail financial products to their customers. We do not own securities firms or insurance companies, and certainly do not take on the underwriting risk of these products – nor do we wish to. We do not deal in foreign derivatives trading, nor do we have our own proprietary mutual fund products to steer our customers toward. Under a CBC structure, community banks should be prohibited from the underwriting risk of non-core banking activities (securities and insurance products), but should be able to provide similar products and services through third party arrangements or agency ownership.

Structure. The CBC should have charter choices – either state or national. Additionally, they should be able to organize as either a C- or S-Corp. As many community banks enjoy widespread ownership among members of their respective communities, they do not qualify for Subchapter S treatment. If an institution qualifies as a CBC, they should also be eligible for Sub S treatment. Also, a bank should be eligible to be a CBC based upon activities and risk profile – not on asset size. While we believe that stock ownership is important for a number of reasons, we believe that a mutual structure should be explored as an option.

Regulatory Oversight. Regulators will be directed to establish streamlined examination procedures for these "non-complex" banks. Specific laws and regulations should be amended to provide a more reasonable regulatory environment commensurate with the risk profile of these institutions.

Deposit Insurance Fund. Vastly different risk profiles, concentration of assets in a few large institutions, desire for different coverage levels, etc. indicate the need for a serious look at a segregated or separate fund. In a recent speech (PR-30-2004), FDIC Chairman Donald Powell discussed the "bifurcated" industry, and the substantial differences in the activities and risk profiles of community banks and the mega-institutions. We applaud Mr. Powell's bold commentary, and look forward to a serious exploration of this issue.

Tax Treatment. Some level of tax parity with the credit union industry is critical to remain competitive over the long term. The present situation is simply not acceptable. In addition to the fairness issue, this will provide additional economic stimulus at the local level. Economic activity and job creation will result from increased lending activity and lower costs. We recognize that while specific industry tax reductions are problematic from a political standpoint, the reality is that such a bold move would be at worst revenue neutral, and would most likely result in substantial economic benefit.

Banks are in the unique position to be a catalyst for the creation of economic activity. Each dollar that is not paid in taxes can be retained as a dollar in the capital, or net worth, of a bank. That dollar can support roughly $12.50 in deposits, of which some 70% can be reinvested back into the community in the form of loans to generate additional economic activity and job creation.

The efficient allocation of capital is a key component of capitalism and economic growth and prosperity. We believe that a migration toward a totally tax exempt banking system in the form of credit unions is disruptive not only for the federal treasury and our industry, but to the economic system on a micro- and macro scale.

We believe that this plan will also encourage more new bank charters, and as importantly, discourage the sale of existing community banks to larger competitors. Additionally, we are hopeful that, moving forward, enactment of this plan will reverse some of the disturbing trends vis-à-vis our large bank and credit union competition.

This is clearly a process, and my comments represent some of the thoughts we have to address some very serious issues impacting our industry. This hearing is an extremely important first step in what we hope will be a serious attempt to address competitive issues, and ensure the long term viability of a community banking industry that has served this nation well for decades.

I want to thank the Chairman and members of this Committee for convening this hearing. On behalf of all of the community bankers across the country, thank you for your consideration of these serious issues that we have placed before you today.

Statement

Of

Judith A. Kennedy
President and CEO

National Association of Affordable Housing Lenders

Before the

Subcommittee on Financial Institutions and Consumer Credit
House Committee on Financial Services
U.S. House of Representatives

May 12, 2004

The National Association of Affordable Housing Lenders (NAAHL) are America's leaders in moving private capital to those in need. Started in 1990, NAAHL encompasses 200 organizations committed to increasing private lending and investing in low- and moderate-income communities. Members are the "who's who" of private sector lenders and investors in affordable housing and community and economic development: banks, thrifts, insurance companies, community development corporations, mortgage companies, loan consortia, financial intermediaries, pension funds, foundations, local and national nonprofits, and public agencies. The Community Reinvestment Act has been central to our work.

CRA MATTERS TO COMMUNITIES

The Community Reinvestment Act (CRA) is one of the least known but perhaps most remarkable success stories of domestic policy. Originally intended to stop so-called "redlining" of neighborhoods, the law requires insured depository institutions to meet the credit needs of their communities, including low- and moderate-income communities. As Federal subsidies for affordable housing and community and economic development have diminished, the availability of private capital provided by these institutions has been critical to non-profit providers and local governments that try to leverage limited subsidy dollars.

To put CRA's importance in perspective, recall that the annual HUD budget is approximately $31 billion, but after renewal of existing subsidy contracts, only about $12 billion remains to address all of the other affordable housing and community development needs throughout the country. Insured depository institutions, in partnership with local non-profit organizations and governments, fortunately leverage limited federal and state dollars many times over.

For example, on an annual basis Bank of America has provided more than $35 billion in loans, investments, and services in low- and moderate-income neighborhoods in the states in which it operates, and with its acquisition of Fleet has committed about $70 billion per year. Similarly, JPMorganChase has just committed to provide about $75 billion annually in the states in which they and Bank One operate. Washington Mutual has committed to providing $35 billion each year. Mid-sized institutions have also committed heavily to lending, investing and providing services in their communities. They are key contributors to many local efforts to develop affordable housing and improve their communities and local economies.

Every government and academic study of CRA, including one by the Federal Reserve Board, has documented insured depository institutions achievements in carrying out their affirmative obligations to make loans, investments, and provide services in underserved rural and inner city communities. CRA is the key to building emerging markets for the future, and lending and equity investing in underserved communities has already spurred economic growth and demand, thereby increasing opportunities to make more loans and sell more services. Done properly, CRA business is sustainable.

Two sociology professors at George Washington University even recently documented "a substantial and statistically significant relationship between mortgage lending" and a decrease in crime. Professors Charis Kubrin and Gregory Squires observed that "lending to low-income borrowers (over the past 10 years) grew by 91%, compared with just over half that for wealthier borrowers" and "lending to blacks and Hispanics increased by 80% and 186%, compared with 30% for whites, at the same time violent and property crimes dropped by 23%." They concluded as so many have before, that "investment matters. Policy counts. The CRA and other fair lending rules have increased access to home mortgage loans and other types of credit in the nation's cities. And now there is evidence that such investment can and does have an ameliorative effect on neighborhood crime rates."

FIRST, DO NO HARM: PROPOSALS TO RAISE THE THRESHOLD

NAAHL is greatly concerned that the regulatory agencies' proposal to double the threshold from $250 million to $500 million for institutions eligible for "streamlined" testing may disadvantage underserved communities in inner city and rural areas. We are disappointed that the agencies did not analyze the likely impact of this proposal on affected communities in the two years between the close of the ANPR comment period and the date of this proposal, and we urge the regulators not to proceed with this proposed change if, as we believe, it adversely affects many communities.

This proposal has been couched in terms of "reducing regulatory burden", and that is a hard concept to oppose. But the practical effect of this proposal is to eliminate most CRA compliance responsibility for 1100 more institutions. These 1100 institutions will no longer be required to demonstrate that they are making investments in their communities. Nor will they have to demonstrate to regulators the distribution of their loans and services, including to low- and moderate-income communities.

Throwing the baby out with the bathwater is not an appropriate solution. NAAHL has been a leader in identifying defects in the regulations that we all know need fixing, and copies of our comments are attached. Nearly a decade after wise regulators called for a thorough review of the regulations in 2002, plus an extensive 3 year review process, nine years of practical experience with the "new" regulations, and the Notice's thoughtful analysis of problems with the current regulations, the Notice fails to address the real world shortcomings in the 1995 regulations. Both small and large banks deserve regulations that recognize quality as well as quantity in meeting the credit needs of the community, provide consistent treatment, and don't set artificial benchmarks that only have relevance inside the Beltway.

Let me highlight for you just some of the consequences for your home states of raising the threshold. If the $500,000 threshold is adopted, the FDIC projects that it will cover 1,131 institutions with assets of about $400 billion dollars. The cumulative asset size is significant, approximating the size of several major U.S. bank holding companies. This proposal would leave only 12% of our nation's insured depository institutions subject to demonstrating affirmatively that they meet the regulations' "3 part test" of investing, lending and services in their communities.

Should the threshold be quadrupled, to institutions with $1 billion in assets, as has also been suggested, that will exempt another 524 institutions with assets of about $370 billion, the size of another major bank holding company, leaving only 6% of FDIC insured institutions that are covered.

Because there has been no analysis of the availability of mortgages and small business loans for low-and moderate-income communities from alternative providers, we only know that the "streamlined" test will relieve mid-sized institutions from documenting that they provide such loans.

But we can estimate the potential decrease in community investments. A recent American Banker article quoted an analysis of CRA exams by a former FDIC official as suggesting that institutions that achieve an "outstanding" rating "typically commit 1.18% of assets" to qualified CRA investments. If the average for all institutions is half that amount, doubling the threshold means that institutions that have documented investments of at least $24 billion of private capital in their communities will no longer have the requirement to invest; a $1 billion threshold would exclude still another $24 billion.

Over the past decade CRA investment dollars have been the primary source for funding low-income housing credits, New Markets' Credits, Historic Credits, and community homeless shelters. They have funded innovative community and economic development initiatives. Some institutions may continue to invest in their communities without a Federal requirement, but the question is whether they will do so at the same level.

Some states could see significant differences. For example, Vermont, which currently has 7 institutions with nearly $6 billion in assets required to lend and invest in low- and moderate-income areas, will have only 2 institutions with assets of $4 billion. As a result, just doubling the threshold means that at least $12 million that Vermont institutions have invested in their communities would no longer be required. If the threshold is $1 billion, only one institution in Vermont, with assets of $3 billion, would still be subject to the investment test.

Ohio would go from its current 82 covered institutions to 44, under the regulators' proposal, potentially reducing investment in affordable housing and community and economic development by at least $78 million. If the threshold is raised to $1 billion, only 26 institutions in Ohio will be required to invest.

Alabama would go from 35 covered institutions to 18 or 9. Just doubling the threshold, as the regulators propose, could mean at least $33 million less invested in Alabama communities.

As you can see from the attached chart, Nebraska would go from 20 covered banks to 8 or 5; North Carolina would go from 40 currently to 25 or 8; Louisiana would go from 30 institutions to 8 or 4 covered institutions; California would go from 152 to 98 or 64.

PARTICULAR IMPACT ON RURAL COMMUNITIES

In many rural areas, it is our understanding that institutions with assets between $250 million and $500 million comprise a substantial share of the market, and that low-income households comprise a substantial share of these communities. Because low-income households are often less geographically concentrated in rural areas than in urban areas, it is important that the regulators recognize that rural areas without large "pockets of poverty" still may have many low-income households who benefit from institutions detailing their lending, investment, and services.

SECTION 8 FUNDING CRISIS

There is another major cloud on the horizon of this successful partnership by which governments have leveraged significant amounts of private capital with scarce subsidy dollars. We are very concerned that HUD's unprecedented Section 8 voucher renewal policy will have very negative repercussions for private sector efforts to provide affordable housing, and on several different levels. Last month HUD announced that it would no longer pay the full cost of subsidy.

According to the National Association of Housing and Redevelopment Officials' preliminary estimate, the change could affect thousands of current voucher-assisted households and hundreds of the nation's 2,500 housing agencies in virtually every state, particularly those in cities where private market housing and utility costs outpace HUD's modest inflation adjustment factor. The impacts will be enormous.

First, not only will some families who lose vouchers also lose their homes, but even those who are lucky enough to keep their vouchers may find it more difficult to rent in the future. Just as it took time for private landlords to become comfortable accepting vouchers, cancellations will discourage landlords from renting to voucher holders going forward.

Second, conventional lenders and rating agencies have only during the past few years become somewhat comfortable with the so-called "appropriations' risk" of relying on some level of government subsidy when making long-term investment decisions. HUD's actions will now exacerbate that concern and introduce a new disaster scenario to the underwriting process. These risks undoubtedly will deter many conventional lenders from financing assisted housing. Others may devise ways to mitigate these underwriting concerns, but the mitigation itself will reduce the amount of private capital leveraged by subsidy, which will significantly decrease the number of affordable units that can be developed for the same amount of public resources.

Third, there are undoubtedly many projects in development or construction in which the financing relies on Section 8 vouchers going to eligible tenants. If the number of vouchers available to these projects is reduced, those projects will now have to go back to the drawing board.

As private lenders and landlords think about this process, they will not differentiate among public decision-makers, whether it be HUD, Congress, or the local housing agencies causing the displacement; rather, it will only confirm their worst fears about public-private partnerships. NAAHL and many other stakeholders hope to work with you to ensure that HUD does not inadvertently make it harder to leverage private capital for affordable housing.

FDIC - Division of Supervision and Consumer Protection
FDIC Insured Institutions as of 12/31/2003
By Asset Category and State

		LT 250 Mil	250 Mil - 500 Mil	500 Mil - 1 Bil	GT 1 Bil	Foreign	Total
AK	Institutions	4	1	1	1		7
	Total Assets	614,895	309,466	738,121	2,200,677		3,863,159
AL	Institutions	127	17	9	9		162
	Total Assets	12,292,807	5,590,031	5,626,128	191,242,097		214,751,063
AR	Institutions	134	26	6	4		170
	Total Assets	14,356,231	8,821,012	4,281,788	10,700,947		38,159,978
AS	Institutions	1					1
	Total Assets	73,133					73,133
AZ	Institutions	38	4	3	5		50
	Total Assets	3,196,300	1,620,138	1,978,548	53,943,401		60,738,387
CA	Institutions	167	54	34	63	1	319
	Total Assets	18,339,570	19,060,955	24,743,790	900,772,287		962,916,602
CO	Institutions	135	32	6	7		180
	Total Assets	11,740,884	10,673,130	4,088,756	8,845,222		35,347,992
CT	Institutions	32	12	11	8		63
	Total Assets	4,059,220	4,434,874	6,994,653	40,395,575		55,884,322
DC	Institutions	5					5
	Total Assets	820,521					820,521
DE	Institutions	8	8	1	17		34
	Total Assets	854,242	2,910,329	699,792	211,717,801		216,182,164
FL	Institutions	221	39	23	21		304
	Total Assets	25,236,498	13,245,831	16,539,010	55,657,261		110,678,600
FM	Institutions	1					1
	Total Assets	83,325					83,325
GA	Institutions	270	53	11	11		345
	Total Assets	27,967,014	18,016,882	7,290,743	160,802,475		214,077,114
GU	Institutions	2		1			3
	Total Assets	210,833		706,404			917,237
HI	Institutions		2		6		8
	Total Assets		888,063		31,040,428		31,928,491
IA	Institutions	386	20	12	4		422
	Total Assets	29,414,288	6,982,046	8,103,969	11,432,215		55,932,518
ID	Institutions	9	7	2			18
	Total Assets	1,047,035	2,612,698	1,068,167			4,727,900
IL	Institutions	602	93	41	34	2	772
	Total Assets	54,040,346	32,871,066	28,878,061	460,418,104		576,207,577
IN	Institutions	147	28	16	15		206
	Total Assets	16,351,862	9,411,645	11,788,823	79,877,873		117,430,203
KS	Institutions	343	19	11	7		380
	Total Assets	20,767,387	6,855,163	7,340,555	18,094,915		53,058,020
KY	Institutions	213	18	7	5		243
	Total Assets	21,785,782	6,229,890	4,210,929	15,242,074		47,468,675
LA	Institutions	140	22	4	4		170
	Total Assets	13,369,473	7,951,122	2,354,048	30,057,015		53,731,658
MA	Institutions	100	59	26	24		209
	Total Assets	12,751,322	21,358,413	18,506,640	161,546,671		214,163,046
MD	Institutions	79	26	8	9		122
	Total Assets	8,561,134	9,362,900	5,802,996	19,016,095		42,743,125
ME	Institutions	16	13	9	2		40
	Total Assets	1,575,757	5,069,125	5,574,471	28,046,143		40,265,496
MI	Institutions	129	28	8	13		178
	Total Assets	15,505,046	10,051,245	5,212,420	166,586,797		197,355,508
MN	Institutions	450	25	7	4		486
	Total Assets	31,690,926	8,405,738	4,478,010	64,105,427		108,680,101
MO	Institutions	314	40	12	11		377
	Total Assets	25,963,855	13,437,519	7,789,760	39,646,577		86,837,711
MS	Institutions	78	14	4	7		103
	Total Assets	7,691,648	4,670,389	2,455,961	25,237,805		40,055,803
MT	Institutions	68	8	3	1		80
	Total Assets	4,819,434	2,767,122	2,088,002	3,859,412		13,533,970
NC	Institutions	64	15	17	8		104
	Total Assets	7,550,064	5,258,607	12,818,424	1,076,259,014		1,101,886,109
ND	Institutions	92	4	5	3		104
	Total Assets	5,648,948	1,377,732	3,457,599	10,277,517		20,761,796
NE	Institutions	250	12	3	5		270
	Total Assets	15,144,916	4,529,953	2,329,322	23,602,218		45,606,409
NH	Institutions	16	9	3	3		31
	Total Assets	2,082,727	3,043,066	1,987,670	22,578,405		29,691,868

Financial Management and Reporting
[kmd]
Data from VISION on 3/12/2004
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RptSpitler20031231

FDIC - Division of Supervision and Consumer Protection
FDIC Insured Institutions as of 12/31/2003
By Asset Category and State

NJ	Institutions	71	30	16	29		146
	Total Assets	8,985,897	11,357,351	11,017,889	120,809,313		152,170,450
NM	Institutions	46	8	1	5		60
	Total Assets	4,768,664	2,988,188	791,758	11,981,436		20,530,046
NV	Institutions	21	5	3	8		37
	Total Assets	2,458,544	1,860,664	2,559,950	52,326,452		59,205,610
NY	Institutions	92	43	25	46	12	218
	Total Assets	10,278,076	14,728,613	17,653,218	1,690,955,740		1,733,615,647
OH	Institutions	222	38	18	26		304
	Total Assets	20,510,322	13,023,430	12,655,853	602,002,909		648,192,514
OK	Institutions	250	15	6	7		278
	Total Assets	18,306,178	4,756,970	4,264,170	29,455,690		56,783,008
OR	Institutions	24	6	4	4		38
	Total Assets	2,346,489	1,939,056	2,415,237	14,694,566		21,395,348
PA	Institutions	137	62	37	34		270
	Total Assets	14,925,714	21,734,860	24,394,054	236,014,368		297,068,996
PR	Institutions			1	10		11
	Total Assets			576,236	77,563,782		78,140,018
RI	Institutions	7	1	2	5		15
	Total Assets	554,764	282,755	1,670,065	213,974,164		216,481,748
SC	Institutions	75	11	4	7		97
	Total Assets	8,329,046	3,409,271	2,658,699	26,313,884		40,710,900
SD	Institutions	75	8	7	4		94
	Total Assets	4,555,215	3,165,225	5,462,867	72,237,655		85,420,962
TN	Institutions	158	33	10	7		208
	Total Assets	16,169,614	11,873,556	7,056,733	83,520,070		118,619,973
TX	Institutions	588	47	32	30		697
	Total Assets	48,854,763	15,883,518	22,410,821	113,039,714		200,188,816
UT	Institutions	39	9	7	9		64
	Total Assets	2,861,708	3,358,644	4,058,055	140,623,319		150,901,726
VA	Institutions	72	41	16	12		141
	Total Assets	8,757,769	13,416,301	11,695,379	147,723,761		181,593,210
VI	Institutions	2					2
	Total Assets	146,436					146,436
VT	Institutions	12	5	1	1		19
	Total Assets	1,723,532	1,773,450	972,664	2,983,589		7,453,235
WA	Institutions	58	13	18	11		100
	Total Assets	5,356,093	4,584,373	11,939,254	56,517,331		78,397,051
WI	Institutions	252	36	11	12		311
	Total Assets	24,142,941	12,617,484	7,309,198	65,339,810		109,409,433
WV	Institutions	62	9		3		74
	Total Assets	6,540,484	3,147,299		9,291,217		18,979,000
WY	Institutions	42	3	1			46
	Total Assets	4,031,679	967,535	562,234			5,561,448
Total Institutions		6,946	1,131	524	581	15	9,197
Total Total Assets		630,211,351	394,684,693	362,057,894	7,690,571,218		9,077,525,156

N A A H L

NATIONAL ASSOCIATION OF AFFORDABLE HOUSING LENDERS

April 2, 2004

NAAHL GOLD MEMBERS
Bank of America
Bank One
Century Housing
Countrywide Home Loans
Fannie Mae
JPMorganChase
Massachusetts Housing Investment Corporation
Washington Mutual Bank
Wells Fargo & Company

NAAHL SILVER MEMBERS
The Community Preservation Corporation
FleetBoston Financial
Harris Bank
HSBC Bank USA
LaSalle Bank Corporation
Merrill Lynch Community Development Company
Neighborhood Reinvestment Corporation
The Northern Trust Company
Wachovia Corporation

NAAHL BRONZE MEMBERS
Bank of New York
Bank of the West
Capital One
California Community Reinvestment Corporation
CharterMac
Community Investment Corporation
Enterprise Foundation / EHFS
FHLBanks
Local Initiatives Support Corporation/ National Equity Fund
National Housing Development Corporation
Ohio Capital Corporation For Housing
Prudential Mortgage Capital Company
RED CAPITAL GROUP
ShoreBank

President & CEO
Judith A. Kennedy

Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552

Attention: No. 2004-04

Dear Sirs:

Members of the National Association of Affordable Housing Lenders (NAAHL) appreciate the opportunity to comment on the proposed changes to the Community Reinvestment Act (CRA) rules.

NAAHL represents America's leaders in moving private capital to those in need. Our nearly 200 member organizations include 71 insured depository institutions, 50 non-profit providers, GSEs, insurance companies, pension funds, foundations and others committed to increasing private capital lending and investing in low- and moderate-income communities.

We are very concerned that the proposals contained in the joint interagency Notice of Proposed Rulemaking (NPR) regarding the Community Reinvestment Act could turn back the clock on efforts to meet the credit needs of our communities. This will summarize our major concerns.

THE NPR FAILS TO ADDRESS LEGITIMATE PROBLEMS

Nine years have elapsed and a century has turned since the current rules were written. And what we have learned is that these regulations pressure institutions to do what is right for the call report, and actually discourage them from tackling the toughest credit needs of their communities. We learned that the existing regulations discount the importance of doing the really hard stuff, like the multi-layered, subsidized, affordable rental housing deals and the redevelopment of distressed neighborhoods. We learned that the regulations force institutions to twist straightforward loans in low- and moderate-income neighborhoods into "investments" to meet an arbitrary benchmark test set by examiners. We learned that, in some communities, there are very limited opportunities for

NAAHL Office
1300 Connecticut Ave., NW / Washington, D.C. 20036 / Tel. (202) 293-9850 • Fax (202) 293-9852 / naahl@naahl.org

sustainable business investments, and finding the eligible "needle in the haystack investment" forces lenders to use resources unproductively.

The tremendous importance of what we learned over the past decade confirms the regulators' wisdom in calling for a thorough review of the regulations in 2002. Nonetheless, after this extensive review process and the proposed Notice's thoughtful discussion of the many issues NAAHL and others raised about the economic distortions associated with the current lending and investment test regulations, the Notice for the most part fails to address the problems.

We do not agree with the stated view of the Notice that the problem is solely one of "implementation". Rather, we believe that the rules are the problem, effectively discouraging institutions and their community partners from using limited resources to meet the greatest needs. And given that the agencies have spent the past 2 to 3 years reviewing concerns with the current regulations before agreeing to this very limited proposal, the prospect for "future guidance" that helps restore some balance seems very dim indeed.

THE NPR PROVIDES THE WRONG SOLUTION TO THE PRACTICAL PROBLEMS WITH THE REGULATION

Rather than put forward the optional "Community Development Test" NAAHL proposed to address the real-world shortcomings in the 1995 regulations, or make any constructive effort to support the complicated, multi-layered, multi-subsidy housing and community and economic development projects most needed in low- and moderate-income communities, the Notice merely responds to one subset of the investment test problem – "comments that smaller institutions at times have difficulty competing for investments" – by simply relieving more than 1,200 institutions from investing, as well as from detailed reporting on loans and services.

At the FDIC meeting on the Notice, agency staff reported that this change was being made without any analysis of the impacts of such a change on affected communities.

We urge that the agencies make some effort to strengthen the community and qualitative focus of the current regulations for all institutions, in the spirit of the mandated review of how the regulations have worked over nearly a decade. Just doubling the

threshold for compliance, without understanding all of the ramifications of that decision, is the wrong solution.

THE NPR APPEARS A RETREAT FROM EXISTING, STRONGER STANDARDS AGAINST PREDATORY LENDING

Despite strong language in the Preamble about the regulators' intention to examine "all credible evidence" that an institution might be involved in abusive lending practices, that broader standard is very unclear throughout the rest of the proposals. Some even interpret the proposals as providing a new "safe harbor" for abusive practices other than asset based lending. If the agencies' intent was to clarify the kind of "credible evidence" that could impair an institution's overall CRA rating, the Notice should be revised to make that clear.

We urge you to reconsider the significance of what you proposed to do, as well as the importance of what you did not do. As always, we are happy to meet with you to discuss our concerns, and look forward to working with you to address legitimate, practical problems with the CRA regulations, to further our mutual goal of meeting communities' credit needs.

Sincerely,

Judith A. Kennedy

Judith A. Kennedy
President

N A A H L
NATIONAL ASSOCIATION OF AFFORDABLE HOUSING LENDERS

April 5, 2002

John D. Hawke, Jr.
Comptroller of the Currency
Office of the Comptroller of the Currency
Independence Square
250 E Street, SW
Washington, DC 20219-0001

Dear Jerry,

This responds to your challenge to NAAHL to develop a proposal for updating the CRA regulation. By way of background, the 3 principles underlying NAAHL's approach to CRA and Community Development and informing this proposal are:

Sustainability: No loan or investment should be made which is not viable in its own right – meaning that it can achieve its developmental purpose over time without continued sustaining financial intervention. However, a comprehensive community development (CD) strategy will include grants and other types of financial assistance to low- and moderate-income (LMI) individuals and organizations.

Flexibility: The key to what is allowable and creditworthy under CRA should be "what works", i.e., what loans, investments, and services contribute to improvement in the lives of LMI individuals.

Responsiveness to community/market needs: Banks should be able to create, change, and modify their CRA oriented programs to reflect changed conditions in their markets and communities. Examiners should recognize such changes in community and market conditions and reward CRA programs that work.

<u>The Community Development Oriented Plan:</u>

As an option (not dissimilar to the choice available with the "Strategic Plan"), a bank could choose as an alternative to the standard Lending, Investment, and Service Tests, to be assessed under two new tests which differentiate between the community reinvestment responsibility to provide financial services to the institution's assessment community on the one hand, and the narrower but pressing need to assist LMI individuals and/or revitalize the communities within which they live or work. These alternative tests would be:

- Retail Banking Test – consisting of mortgage loans, small business loans, consumer loans (optional), and retail banking services. This would be similar in scope to the existing small bank test.

- Community Development Test – consisting of community development lending, community development investments, and community development services.

The Retail Banking Test will measure the institution's success in meeting the credit and financial service needs of its assessment area. These activities (whether lending or services) will be included in the Retail Banking Test as a component of the institution's assessment area activity and to ascertain the institution's distribution of these activities within the assessment community.

The Community Development Test -- Definition and Purpose:

Community Development encompasses those activities of a financial nature or otherwise, which have the effect of improving the life condition of LMI individuals, or of stabilizing and revitalizing the communities in which they live or work. In order to receive community development credit for CRA purposes, a project need not have community development as its "primary purpose", so long as a significant consequence of the project or activity benefits LMI individuals or communities. For example, all of a mixed-income development transaction where the market-rate units *enable* affordable units should count (not just the affordable portion) because the transaction meets the community's need for LMI housing. Another example is a city-sponsored project in a community, which is not LMI, where the institution finances or supports downtown revitalization or rehabbing of an older shopping center where LMI individuals are likely to find employment. In addition, it should not be required that an activity be explicitly "financial" if it works to the benefit of LMI individuals or communities.

The Community Development Test will include, but not be limited to, activities such as the following:

Funding of CDFIs and other community development intermediaries;
Funding community development venture capital funds;
Loans/investments/grants in projects or to organizations which provide housing affordable to LMI individuals, or to LMI communities;
Loans/investments/grants in projects or to organizations which provide jobs, supportive services, or other relevant benefits to LMI individuals or LMI communities;
Facilitating the creation of affordable housing through the use of low income tax credits;
Purchase of mortgage-backed-securities backed by loans to LMI individuals;

Participation in government sponsored programs, such as the SBA, with evaluation based on the LMI definition that the specific government entity uses;
Grants to organizations engaged in community development activities;
Providing financial education and banking services tailored to the needs of the unbanked;
Equity investments in organizations, small businesses, or other projects for the purpose of community development;
The initiative shown by the institution in developing unique/special LMI targeted lending programs; and
Related activities such as:

- Providing standby letters of credit or other credit enhancements supporting community development projects (to be included and itemized in the CRA Loan Disclosure);
- Applications to the Federal Home Loan Bank for support of community development projects, the contingent liability taken on with such projects, and employee time spent in administering and monitoring these activities;
- Employee time devoted to a large variety of community development activities, such as construction of homes through the auspices of organizations such as Habitat for Humanity;
- Bank officers and other employees participating in community development organizations, even if they include non-financial activities.

When examining an institution's community development program, the Examiner would look to the totality of the bank's community development activity, recognizing that the balance among community development lending, investments, services and other related activities may vary substantially from bank to bank and community to community so long as the total impact of the bank's community development outreach is consistent with its performance context and institutional expertise, and meets a reasonable standard related to community needs.

Weighting:

If an institution were to choose this alternative plan for satisfying its community reinvestment responsibility the weighting for each test would be agreed upon prior to the examination, with the weighting for the Community Development Test to be no lower than 25% and no higher than 50% of the total. In keeping with the overriding consideration of flexibility in the direction each institution takes in meeting its community development responsibilities and the flexibility Examiners have to evaluate the totality of an institution's program without rigid adherence to hard and fast allocations, we believe that weighting should be determined within the context of the individual institution's business strategy and the needs of its community. As an example, an institution which does not offer a

particular product line would be evaluated with weightings based on the products it does offer.

HDMA, Small Business, and (Optional) Consumer Loans:

HMDA and Small Business loans will continue to be reported as they currently are, and considered in the retail banking test. Standby letters of credit or other credit enhancements supporting community development projects will be reported and included under the Community Development Test, as noted above. There will be no double counting of loans, investments, or services. For examination purposes, all activities will be categorized as falling under the Retail Banking Test or the Community Development Test.

Determination of Which Test to be Examined under:

At the time when the Regulator notifies a bank of an upcoming CRA Examination, but no more than 12 months prior to an exam, the bank will inform the Regulator of its wish to be examined under the standard Lending, Investment, and Service tests, or its preference to be examined under the Retail Banking and Community Development tests. This flexibility allows that even though a bank might normally be expected to opt for and develop its CRA plans for one or the other of the alternate examination processes, changing bank circumstances and community/market conditions may prompt the bank to change its program in such a way as to make the alternative testing standard appropriate.

Thank you for the opportunity to suggest this approach. We would look forward to continuing our dialogue on these important matters.

Sincerely,

Judith A. Kennedy
Judy Kennedy
President

N A A H L

NATIONAL ASSOCIATION OF AFFORDABLE HOUSING LENDERS

October 19, 2001

Ms. Jennifer Johnson
Secretary, Board of Governors of
The Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Docket No. R-1112 – Advance Notice of Proposed Rulemaking Regarding the Community Reinvestment Act Regulation

Dear Ms. Johnson:

The National Association of Affordable Housing Lenders (NAAHL) represents more than 200 organizations, including more than 85 insured depository institutions, and 800 individual community investment practitioners who are committed to increasing the flow of private capital into low- and moderate-income communities. As you know from our ongoing dialogue with all of the bank regulators, our experience suggests the importance of several mid-course corrections to the rule, both to ensure the sustainability of this business, and encourage meaningful community investment in this new millennium. Our thoughts on the specific issues are as follows.

Large Retail Institutions: Lending, Investment, and Service Tests

Do the regulations strike the appropriate balance between quantitative and qualitative measures, and among lending, investments, and services? If so, why? If not, how should the regulations be revised?

It is important to restore some balance between consideration of quantitative and qualitative factors to ensure both that CRA business is not over-subsidized in a non-sustainable way, and to permit the institution to do what is right for the community rather than for the call report.

The Problem

While the 1995 regulation made great progress in bringing credibility to CRA performance, some aspects of it have gone too far in the quantitative direction. The emphasis on statistical information -- to provide the public with information about the extent to which insured depository institutions make loans and investments -- can be so great as to obscure the community needs, performance context, and business case for some loans and investments. This

overemphasis also obscures the fact that all communities do not have the same needs, just as all institutions do not have the same expertise. This inevitably results in some unintended distortions. For example, a community may not have much demand for investments or even certain types of loans, such as mortgages for multifamily housing. Nonetheless, examiners are reluctant to acknowledge the performance context in which institutions operate, requiring that institutions make their "numbers". This can result, at best, in non-productive resources being spent finding the needle in the haystack, or at worst, in perverse economic consequences when too many lenders are chasing the same deal. It focuses institutions on competing where markets are well served, when it would be more valuable for the community for institutions to address unmet needs.

In addition, many practitioners' experience with the investment test leads them to question whether it should continue as a standalone test, as well as the weight given to it. Most NAAHL members believe that mid-course corrections are particularly important for the long-run effectiveness of CRA. Various proposals for reform seem to reflect differences both in assessment area needs and an institution's market niche, as well as the proliferation of some hyper-competitive market areas, along with the extent to which an institution's examiners appreciate the performance context.

It is clear that the quantitative emphasis, combined with low or no demand for viable investments in some communities, results in pricing distortions and unsustainable business in some markets. In addition, where there is high demand for loans but little or no need for investments in an assessment area, the pressure to find "investments" causes non-productive bank resources to be spent twisting a straightforward business opportunity like a loan into a qualifying "investment". Finally, many investments, such as in small tax credit deals, are largely illiquid, yet regulators are reluctant to continue to give CRA credit for the period in which the bank's capital is tied up in these deals.

It is understandable that examiners find it difficult to evaluate activities that are not easily measurable. Initiatives that are truly innovative or complex are very resource-intensive, and because they often address the most acute needs in a community, generate low numbers. Nonetheless, careful, qualitative assessment of these initiatives, such as lending on tribal lands or stimulating new commerce in Appalachia, is critical to encouraging institutions to address the greatest needs.

Recommendations
To address the imbalance between quantitative and qualitative factors in assessing CRA performance, we have several suggestions. First, both non-profit organizations and insured depository institutions suggest that all of the qualitative aspects of CRA performance be reorganized into a single, separate community development test. This new test would incorporate all community development lending, community development investments, and community development services.

Such a regrouping should not only provide a better balance, but also afford more flexibility to institutions to design CRA programs that match community needs with their business strategies. It should be simpler to analyze an institution's community development activity as a whole. Most important, it should make it easier for an institution to make the greatest effort where the greatest need exists, without a requirement to meet artificial ratios, twist loans into "investments", or make "investments" that are written off as grants.

The purpose of the combined test would be to follow the format of the wholesale/limited purpose Community Development Test, whereby an institution can choose to focus on one or more of the three components. This type of flexibility will allow an institution to target its resources to areas of need based on their local communities and synergies with the institution's areas of expertise and operational infrastructure.

Second, greater emphasis must be given to the Performance Context in evaluating banks' performance. All communities do not have the same needs, and all institutions do not have the same business strategies. Examiners must consider unique community needs as well as how well markets are being served and legitimate barriers to real needs.

Third, our members also are concerned about consistent application of the rules across all regulators and all geographic areas. Inconsistent interpretation and application of the rules has been a continuing problem and should be addressed by regulators in the context of the CRA rewrite.

Does the Lending Test effectively assess an institution's record of helping meet the credit needs of the entire community?

Yes -- to an extent. However, as we described above, the undue emphasis on quantitative measures compels lenders to focus on products and services that produce the right "numbers", rather than consider – and respond to – the greatest needs of the community. The pressure to satisfy quantitative

measures leads to uneconomic business in more and more markets, thereby jeopardizing the sustainability of the business. Too often, examiners tend to equate activities that are "innovative" or "flexible" with "unprofitable". Based on the considerable experience practitioners now have with the 1995 rule, we believe that the rule needs to provide institutions with greater flexibility both to respond to each community's unique needs and to align their CRA activities with their business expertise, rather than just play the "numbers" game.

We also believe purchased loans should be given equal weighting to loan originations because loan purchases are equally important in providing liquidity, which helps to lower the cost of mortgage lending.

Does the Investment Test effectively assess an institution's record of helping to meet the credit needs of an entire community?

Investments can be critical to meeting the credit needs of some low- and moderate-income (LMI) individuals and communities. Nonetheless, the overarching measure of a lender's performance in meeting the credit needs of the local community should be how well the institution addresses that community's unique needs, and not an artificial requirement to achieve certain volumes.

Unfortunately, the Investment Test has had many unintended results, some of which we described above. While this test undoubtedly was intended to increase a lender's flexibility in addressing community needs, it has increasingly become something of a millstone. Different communities require a different mix of loans, services and investments to meet their unique credit needs. This separate test and the quantitative emphasis to performance undermine the institution's ability to choose whether investments will help it to meet the credit needs of a particular community.

In some communities, there are very limited opportunities for sustainable business investments. Many so-called investments are, in fact, grants with no expectation of a yield or principal repayment. And, in some affluent communities, there are actually no legitimate investments that benefit low- and moderate-income persons. As a result, "junk" investments have been created and marketed, which provide "numbers" for institutions, often carry high risk and very low yield but do not, in fact, address the real credit needs of the community.

In addition, the current regulations result in little or no credit for investments that occurred prior to the review period that are still on a bank's books. Institutions that are attempting to meet important credit needs with long-term, largely illiquid or below-market-rate investments in local affordable housing or other eligible activity should receive continued credit for such investments.

Does the Service Test effectively assess an institution's record of helping to meet the credit needs of its entire community?

The test has been effective, but now needs to be updated to be more flexible. The rapid growth of alternative delivery methods, such as the internet, telephone and mail, allow delivery of services in new and important ways. If an institution makes effective and extensive use of these alternatives to meet the credit needs of its community, they should be weighed heavily in the exam. Banks should be given credit for *all* they are doing to serve a community beyond just specific branches – for example, establishing a presence in a community facility, maintaining a mortgage lending office, or providing ATMs.

Similarly, the "finance related" tie in the current regulations is too restrictive. Bank employees volunteering with community-based organizations should not be restricted to finance, investment or other finance-related functions for an institution to receive CRA benefit. Institutions should receive CRA credit <u>for all volunteer activities related to community building and development</u>, such as helping to build a home in Habitat for Humanity projects, which contribute to building sustainable communities.

Are the definitions of Community Development appropriate?

Today, community development is a dynamic and innovative business, but the current rules discourage an innovative response to a community's credit needs. The definitions should be expanded to allow more flexibility in responding to a community's needs. The application of the "primary purpose" concept is too restrictive. We recommend that, going forward, consideration of community development include, but not be limited to, activities such as the following:

- loans to LMI individuals or communities;
- loans or investments in projects that provide housing, jobs or other benefits to LMI individuals or communities;
- provision of financial services to LMI individuals or communities;
- grants to organizations that engage in community development activities;
- equity investments in organizations or projects for the purpose of community development;
- related activities, such as letters of credit or other credit enhancements supporting community development projects or applications to the Federal Home Loan Bank for supporting community development projects.

Activities that enable community development also should count as qualified investments. For example, all of an investment in a mixed-income development where the market rate units *enable* affordable units should count (not just the portion which is affordable) because the investment meets the community's need for credit to integrate LMI households.

In addition, we support the need for a simplified method of determining whether a multifamily project is "affordable housing for LMI individuals", thereby meeting the definition of "community development". One method we support was recommended in Fannie Mae's 1999 comment letter to the FFIEC (see the attached copy).

Small Institutions

Do the provisions relating to asset size and holding company affiliation provide a reasonable and sufficient standard?

These provisions would provide a reasonable and sufficient standard if they followed the asset size of the bank, as opposed to the current practice of following the holding company's asset size.

Limited Purpose and Wholesale Institutions: The Community Development Test

Are the definitions of "wholesale" and "limited purpose" institutions appropriate? If so, why? If not, how should the regulations be revised?

The definition of limited-purpose bank should be expanded to include retail banks that have no branches or that have branches that are incidental to the primary business strategy of the bank. We support expanding the availability of the Community Development Test, allowing a large retail institution to choose the option that best addresses the community's needs and the institution's strengths.

Performance Context

Are the provisions of the performance context effective in appropriately shaping the quantitative and qualitative evaluation of an institution's record of helping to meet the credit needs of its entire community?

The Performance Context should be an important element of the CRA evaluation but, in many instances, it has been extremely difficult to persuade examiners to acknowledge the specific, external environment in which each bank operates. Even in extremely high-cost areas, like New York City, or credit surplus areas, like Wilmington, examiners often seem unable or unwilling to acknowledge the operating environment.

We recommend that the regulators reinforce the critical importance of this necessary, intellectual framework with which to evaluate institutions.

Examiners should receive needed training and resources to enhance their expertise in this work. To the extent possible, regulators should pool resources and data to provide all examiners across all agencies with readily accessible information. The examiners should share with their regulated institutions their assessment of the external environment, and the institution should have the opportunity to review and comment in a productive dialogue with its examiners.

Assessment Areas

Do the provisions on assessment areas, which are tied to geographies surrounding physical deposit-gathering facilities, provide a reasonable and sufficient standard for designating the communities within which the activities will be evaluated during the examination?

If a bank is adequately meeting the credit needs of its assessment area, then all qualified lending, investing and services outside its assessment area should be given favorable consideration. This important flexibility should help communities with unmet needs, and reduce economic distortions in hyper-competitive markets.

Data Collection

Are the data collection and reporting and public file requirements effective and efficient approaches for assessing an institution's CRA performance while minimizing burden?

Collecting the required data, making sure that it is accurate, and maintaining the public file is an increasingly burdensome and expensive undertaking. As more and more institutions operate in many states, and with the recent addition of disclosures mandated by the Sunshine regulations, a tremendous amount of labor and paper goes into this work. The cost/benefit relationship of these requirements should be re-evaluated. It is also important to note that every change in data collection requirements necessitates substantial systems changes and costs at every institution, and further reduces the ability to track trends in lending over time. We suggest that it should be an accepted principle that such changes should only result from a major need in furtherance of CRA.

In this new millennium of technological communications and multi-state financial institutions, the current rules requiring multiple public files now kill way too many trees for little or no benefit. Very few people go into branches and ask for CRA file information. Each institution should provide one paper set of data only, and each branch office should be required to have written contact information to respond to inquiries that tells people the various ways to access all of the institution's information.

Finally, race and ethnic data should not be included in the CRA exam. Fair lending is about fair treatment of protected groups, including racial and ethnic minorities, many of whom are not of low- or moderate-incomes.

We appreciate all of the effort the agencies have made to eliminate unintended barriers to meeting the credit needs of low- and moderate-income persons and communities. We hope that you will take this opportunity to make corrections to the 1995 rule to further increase the flow of private capital and strengthen institutions' ability to meet these credit needs in the new millennium, and we look forward to working with you on these goals.

Sincerely,

Judy Kennedy

Judith A. Kennedy
President

Testimony of

INDEPENDENT COMMUNITY BANKERS OF AMERICA

on

"Cutting Through the Red Tape: Regulatory Relief for America's Community Based Banks"

House Financial Services Subcommittee on Financial Institutions and Consumer Credit
U.S. House of Representatives

May 12, 2004

Dale Leighty
President and Chairman
First National Bank of Las Animas
Las Animas, Colorado

and

Chairman
Independent Community Bankers of America
Washington, D.C.

Mr. Chairman, Ranking member Sanders, and members of the subcommittee, my name is Dale Leighty. I am Chairman of the Independent Community Bankers of America (ICBA)[1] and President and Chairman of First National Bank of Las Animas, a $ 140 million-in-assets community bank located in Las Animas, Colorado.

I would like to thank the subcommittee for examining the important issue of regulatory relief for community banks. This is one of ICBA's top priorities, and I am pleased to testify today on behalf of our nearly 5,000 community bank members to share with you their views and concerns.

Regulation Disproportionately Burdens Community Banks and Impacts Their Communities

ICBA supports a bank regulatory system that fosters the safety and soundness of our nation's banking system. However, statutory and regulatory changes continually increase the cumulative regulatory burden for community banks. In the last few years alone, community banks have been saddled with the privacy rules of the Gramm-Leach-Bliley Act; the customer identification rules and anti-money laundering/anti-terrorist financing provisions of the USA-PATRIOT Act; and the accounting, auditing and corporate governance reforms of the Sarbanes-Oxley Act.

Yet relief from any regulatory or compliance obligation comes all too infrequently. New ones just keep being added. There is not any one regulation that community banks are unable to comply with—it is the cumulative effect of all the regulations that is so burdensome. As ICBA President and CEO, Cam Fine recently stated, "Regulations are like snowflakes. Each one by itself may not be much but when you add it all up, it could crush the building."

Regulatory and paperwork requirements impose a disproportionate burden on community banks because of our small size and limited resources. We have had to devote so much of our resources and attention to regulatory compliance that our ability to serve our communities, attract capital and support the credit needs of our customers is diminished. Moreover, the time and resources community banks spend on regulatory compliance has also resulted in increased costs to our consumer and small business customers. Credit unions and other non-bank institutions that perform "bank-like" functions and offer comparable bank products

[1] ICBA represents the largest constituency of community banks in the nation and is dedicated exclusively to protecting the interests of the community banking industry. We aggregate the power of our members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace

and services are not subject to the same laws and regulations as community banks, thus placing community banks at a competitive disadvantage.

Perennial Problem. Regulatory burden is a perennial problem for community banks. In 1992, Grant Thornton, LLP conducted a study for ICBA on the cost of regulatory burden for community banks—the first to focus solely on compliance costs for community banks. At that time, the study showed the cost of complying with just 13 bank regulations (deemed the most burdensome in the eyes of community bankers), both in terms of time and money, was overwhelming. The annual cost for community for the 13 regulations—just a fraction of the rules that govern the industry—was $3.2 billion, which represented a whopping 24 percent of net income before taxes. In addition, 48 million staff hours were spent annually complying with the 13 regulatory areas.

Impact on Community Banks and Their Customers. Since that time, the market share of community banks with less than $1 billion in assets has dropped from about 20 percent of banking assets to 13 percent. And the share of large banks with more than $25 billion in assets has grown from about 50 percent to 70 percent. Community bank profitability also lags large banks.

At the same time credit unions, with an unfair tax-exempt advantage and favorable legislation loosening membership restrictions, have made inroads into small banks' market segments. Credit union assets have more than tripled since 1984, from $194 billion to $611 billion, whereas small bank (less than $1 billion) assets have decreased in value.

An analysis of these trends conducted by two economists at the Federal Reserve Bank of Dallas concluded that the competitive position and future viability of small banks is questionable.[2] The authors suggest the regulatory environment has evolved to the point placing small banks at an artificial disadvantage to the detriment of their primary customers—small business, consumers and farmers.[3]

ICBA Strongly Supports EGRPRA Review

ICBA is pleased that, at the direction of Congress, the federal bank regulators are currently reviewing all 129 federal bank regulations, with an eye to eliminating rules that are outdated, unnecessary or unduly burdensome. The review is required by the Economic Growth and Regulatory Paperwork Reduction

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[2] Gunther and Moore, "Small Banks' Competitors Loom Large," *Southwest Economy*, Federal Reserve Bank of Dallas, Jan./Feb. 2004.

[3] Community banks are responsible for a disproportionate amount of bank lending to small business, the primary job-creating engine of our economy. Banks with less than $1 billion in assets, make 37 percent of bank small business loans, though they account for only 13 percent of bank industry assets. And they account for 64 percent of total bank lending to farms.

Act of 1996 (EGRPRA). Community banks wholly applaud the EGRPRA effort and fervently hope that it bears fruit.

However, it is important for Congress to recognize there is only so much that the regulators can do to provide relief. Many regulatory requirements are hard-wired in federal statute. Therefore, effective reduction of regulatory burden will require congressional action.

ICBA's Federal Legislation Committee is currently examining ways to reduce the regulatory burden on community banks, and ICBA will present recommendations to Congress in the near future. The agencies will also make recommendations to Congress for legislative relief as a result of their EGRPRA review.

ICBA strongly urges the Congress to be bold and open-minded when considering recommendations offered by the regulators or the industry for regulatory relief.

The Most Burdensome Regulations

The litany of burdensome regulations is long. Here is a partial list:

- A myriad of consumer disclosures—that unfortunately are rarely read by consumers: Truth in Savings, Truth in Lending, Real Estate Settlement Procedures Act, Electronic Funds Transfer, Fair Lending, privacy notices, insurance disclosures, Funds Availability notices;
- Many reporting requirements: Home Mortgage Disclosure Act, Currency Transaction Reports, Suspicious Activity Reports, Call Reports, Regulation O (insider lending) reports, Regulation D (reserve requirements) reports;
- Requirements for written policies and procedures, including annual staff training for: information security, customer identification programs, Bank Secrecy Act, Community Reinvestment Act, and all other aspects of banking including procedures for operations, lending, deposit-taking, investments, advertising, collection, etc. And examiners often ask banks to develop policies and procedures that do not apply to that bank's individual operations!

These regulations are overwhelming to the 37 employees of my bank who must grapple with them everyday.

Feedback from ICBA members indicates that consumer lending and disclosure regulations (including the Truth in Lending right of rescission) are among the most burdensome. Others include: Bank Secrecy Act and anti-money laundering compliance, Community Reinvestment Act, and privacy notices. Many of these concerns apply to banks of all sizes, while others may be of special concern to community banks.

Appendix Attached. Included as an appendix to this written statement is a discussion of regulatory burden presented by a number of specific regulations that has been taken from comments ICBA has provided to regulators as part of the ongoing EGRPRA review and otherwise. It does not cover the full book of bank regulations.

Community Reinvestment Act. The Community Reinvestment Act deserves special mention since regulators have pending a proposal to reduce the regulatory and examination burden it poses on community banks. CRA is a clear example of regulatory overkill. At a time when banking monoliths stretch from coast-to-coast, evaluating the CRA performance of large complex banking organizations and small locally owned and operated community banks on the same examination standards simply does not make sense.

<u>Increased Size Limit for Streamlined CRA Examination.</u> ICBA strongly supports an increase in the asset size limit for eligibility for the small bank streamlined CRA examination process. Although we believe that a preferable threshold would be $2 billion in assets, we applaud the regulators' proposal to increase the limit to $500 million in assets and eliminate the separate holding company qualification. Chairman Bachus, we appreciate the letter you and Rep. Baker organized in support of the proposal.

ICBA also strongly supports Congressman Hensarling's legislation (H.R. 3952) calling for an increase in the CRA small bank size limit to $1 billion, although we would support amending the bill to raise the threshold to $2 billion. We also strongly support the inflation adjustment in the bill to ensure that inflation pressures do not diminish the bill's effect.

Under either the regulatory or legislative proposal, while community banks will still be subject to CRA, many will be free from the more onerous compliance burdens associated with the large bank CRA examination and able to concentrate efforts and resources on serving their communities. The bulk of CRA examination resources should be focused on truly large banks whose hundreds or thousands of local branches never see a CRA examiner, not on community banks that cannot survive unless they serve their communities.

Community activists have suggested that the proposal will "gut" the CRA. This is simply not so. All banks will still be subject to the requirements of the statute and continue to meet the credit needs of their communities. Increasing the small bank size limit will not undermine the purposes of CRA. Instead it will free community banks in the $250 million to $500 million asset range from unnecessary costs, improving their productivity and enhancing their ability to meet the credit needs of their communities.

CRA examination costs place an unfair burden on community banks. If the agencies' proposal is adopted, the regulatory paperwork and examination burden will be eased for 1,350 community banks between $250 million and $500 million

of assets. These banks will no longer be subject to the investment and service tests, nor to CRA loan data collection and reporting requirements. Even so, the percentage of industry assets examined under the large bank tests will decrease only slightly from a little more than 90% to a little less than 90%.

In today's market, an institution with $500 million in assets is not a large bank. When the small bank streamlined examination was first considered, 17 percent of the banking industry's total assets were subject to the small bank exam using a $250 million asset limit. Due to consolidation and changes in industry demographics since then, if the asset limit were increased to $1 billion today, only slightly more than 15 percent of industry assets would be subject to the small bank exam—still less than the percentage of assets covered when the streamlined examination was first adopted nearly ten years ago.

ICBA/Grant Thornton CRA Cost Study. A 2002 ICBA/Grant Thornton study entitled *The High Cost of Community Bank CRA Compliance: Comparison of 'Large' and 'Small' Community Banks* reveals that CRA compliance costs can more than double when community banks exceed $250 million in assets and are no longer subject to streamlined examinations. A survey of community banks showed the mean employee cost attributable to CRA is 36.5 percent higher at large community banks than at small community banks. In each of two case studies—one contrasting costs for a bank that grew from "small" to "large" bank status, and one contrasting costs for a "small" and "large" bank owned by the same holding company—CRA compliance costs were four or more times greater for large community banks than for small ones.

The study further showed that the large bank CRA investment test also represents a cost burden for large community banks, with 92 percent finding the market for CRA investment opportunities "competitive" or "highly competitive" and 69 percent saying such investments are "not readily available." Half reported giving yield concessions to make CRA-qualified investments. Opponents of the proposal contend that community investments will disappear if smaller institutions are no longer subject to the investment test of the large bank CRA examination. We disagree. Community bankers report that they would be involved in the local community and make investments in community development because their success and survival depends on the success and the survival of the community and because they are integral parts of those communities.

It is ironic that community activists complain when larger institutions they consider less responsive to community needs merge with our-of-area banks. Yet the activists oppose critical steps to reduce the burden that is driving community banks to sell to their larger counterparts and, in fact, driving the community bank out of the community. Nevertheless, the cumulative effect of this one-size-fits-all regulation is driving away many of the small banks that have been serving their communities for decades. The ultimate result is that our local communities are losing not only their banks, but their community leaders.

Negative Cumulative Effect of Regulations on Community Banks

Even though each new requirement may be designed to address a particular problem, over time it all adds up to an unwieldy burden. A new rule is not just a new requirement for the bank. There's a lot more to it. First, the rule has to be understood and interpreted. Procedures have to be changed and adapted. Forms and software systems have to be updated to reflect the change. Bank employees have to be trained in the new requirement and given refresher courses from time to time. New audit programs have to be created and implemented to be sure that the new procedures for the new rule are properly followed.

How does the average community bank keep up? It's getting more and more difficult. The typical community bank has $75 million in assets and about 25 employees. During consumer compliance examinations alone, federal regulators review 26 separate consumer compliance rules. That's more rules than the average number of employees! And the time spent on compliance is time the bank is not using to serve its customers.

Moreover, the rules aren't segregated into product types. For example, a banker can't just look in one place for all the regulations applicable to a home equity loan. They have to consider a whole series of rules and regulations, such as Regulation B (Equal Credit Opportunity Act), Regulation C (HMDA), Fair Credit Reporting Act, RESPA, Truth-in-Lending. To make matters worse, the rules don't always match. If a customer wants to apply for a mortgage loan, RESPA and the Truth-in-Lending Act both require early disclosures to provide an applicant with information – but the requirements don't always mesh. After all, they're written by two different federal agencies.

Each rule has certain fixed costs associated with it. A mega bank with thousands of employees can more easily absorb those costs and devote the resources to addressing the new rule. For a small, community bank, the requirements are snowing them under. Unfortunately, many community bankers are seriously considering getting out of the business. When banks lose their local community focus, small businesses – the engines that help drive the economy – no longer have access to the kind of one-on-one relationship with a banker that can make or break the business.

State Law Also Adds Burden. Unfortunately, the Congress and federal regulators do not have a monopoly on regulatory burden. State laws and state regulations also can pose undue burden on community banks. ICBA strongly supports the dual banking system and the strengths it has brought to our economic and financial system. Many of our members are state-chartered and like it that way. But a growing number of state laws and regulations, including those that conflict with federal laws on the same topic, compound regulatory burden.

Tiered Regulation and Proper Allocation of Regulatory Resources

Community banks and large, national or regional banks pose different levels of risk to the banking system, and have different abilities to absorb the costs of regulatory burden For these reasons, the ICBA strongly urges Congress and the agencies to continue to refine a tiered regulatory and supervisory system that recognizes the differences between community banks and larger, more complex institutions.

A tiered regulatory system allocates the costs of regulatory/paperwork burden relative to the risk of the institution and helps restore equity in regulation, leveling the playing field and enhancing customer service. Less burdensome rules and/or appropriate exemptions for community banks are the hallmark of a tiered regulatory system.

Just as banks are urged to focus resources to address the greatest risks, regulators and examiners should reallocate resources to the largest banks that pose the greatest systemic risk. ICBA strongly supports better allocation of supervisory and regulatory resources away from community banks and towards larger institutions that present systemic risk.

From time to time, Congress and the agencies have instituted welcomed regulatory and supervisory policies that lighten the regulatory and paperwork burden for community banks. Examples include: less frequent safety and soundness exams for small, healthy banks; streamlined, risk-focused exam procedures for noncomplex banks; streamlined CRA exams for small banks; and less frequent CRA exams for small, well-rated banks.

Nonetheless, bank regulators devote disproportionate resources to examination and supervision of community banks. For example, one agency, the Federal Reserve, devotes 75% of supervision time to banks with less than $10 billion in assets, yet these banks only hold 30% of aggregate assets and are unlikely to pose systemic risk. Legislators and regulators should address these disparities to better allocate examiner resources and reduce unnecessary burden for community banks.

Conclusion

ICBA member banks are integral to their communities. Their close proximity to their customers and their communities enables them to provide a more responsive level of service. However, regulatory burden and compliance requirements are consuming more and more resources, especially for community banks. The time and effort taken by regulatory compliance divert resources away from customer service. Even more significant, the community banking

industry is slowly being crushed under the cumulative weight of regulatory burden, causing many community bankers to seriously consider selling or merging with larger institutions, taking the community bank out of the community.

The ICBA urges the Congress and the regulatory agencies to address these issues before it is too late. This is especially true for consumer lending rules, which, though well intentioned, too often merely increase costs for consumers and prevent banks from serving customers. The fact that banks and thrifts are closely examined and supervised should be taken into account in the regulatory scheme, and depository institutions should be distinguished from non-depository lenders.

The ICBA strongly supports the current efforts of the agencies and Congress to reduce regulatory burden. We look forward to working to ameliorate these burdens and to identifying statutory changes that should be made to ensure that the community banking industry in the United States remains vibrant and able to serve our customers and communities.

APPENDIX
Regulatory Burden
Comments on Selected Regulations [1]

Truth in Lending (Federal Reserve Regulation Z)

Right of Rescission. Perhaps one of the most troublesome issues of current regulatory requirements is the three-day right of rescission under Regulation Z. Bankers have identified the right of rescission as one of the top ten regulatory complaints. Most of the problems this particular right is designed to rectify originate with non-depository creditors, not banks, a fact that should be considered. Moreover, banks and thrifts are closely examined and supervised to ensure compliance and fair practices, another key point to consider in addressing regulatory burden.

Bankers report that consumers rarely exercise the right of rescission. However, consumers do resent having to wait three additional days to receive loan proceeds after the loan is closed, and they often blame the bank for "withholding" their funds. Even though this is a statutory requirement, inflexibility in the application and interpretation of the requirement makes it difficult to waive the right of rescission and aggravates the problem. The restrictions should be rationalized to reflect consumer desires and modern-day realities. If the requirement is not repealed outright, depository institutions should at least be given much greater latitude to allow customers to waive the right.

Identification of the Creditor. In addition to the right of rescission, community bankers have identified other problems under Regulation Z. In many lending arrangements the bank is not the only party involved in making the loan, creating difficulty and confusion in determining which entity is actually responsible for making the requisite disclosures. For example, banks often enter arrangements with car dealers to offer loan products but do not control the dealer's actions. These arrangements take a variety of formats and involve the bank in the credit at different stages of the process. However, the bank is likely to be held responsible for what the car dealer does or does not disclose, no matter when the bank became involved in the loan. The responsibility for disclosures when more than one creditor is involved should be more clearly outlined and defined so that banks understand when and to what extent they are expected to control the actions of counter-parties to a loan transaction.

[1] This appendix is a discussion of regulatory burden presented by a number of specific regulations that has been taken from comments ICBA has provided to regulators as part of the ongoing EGRPRA review and otherwise. It does not cover the full book of bank regulations.

Advertisements. Another problem under the Truth-in-Lending Act regulation involves how loan products may be advertised. From one perspective, advertisements help educate consumers about available loan products, but existing restrictions on what may be included and what must be included if a certain trigger term is used often limits the information actually included in advertising materials, meaning that consumers get less – not more – information. In some cases, the amount of information included can be virtually meaningless. While the intent is to encourage consumers to visit the bank to get more detailed information, the practical implications and market realities suggest that limiting information has the opposite effect. These restrictions should be greatly relaxed, if not eliminated. Banks are subject to the unfair and deceptive restrictions in section 5 of the Federal Trade Commission Act, and that standard should be more than sufficient for *all* bank advertising. Moreover, bankers question auto dealers' practice of advertising of zero percent financing for cars that fails to disclose all pertinent elements of the loan or that is not available to all but a very few – statements that would get bankers in trouble with their examiners but that place bank lenders at an unfair competitive disadvantage.

Finance Charges. The definition of the finance charge under Regulation Z is a primary example of an unclear regulatory requirement. Assessing what must be included – or excluded – is not easily determined, especially when fees and charges may be levied by third parties. And yet, the calculation of the finance charge is critical in properly calculating the annual percentage rate (APR). Even if that hurdle is overcome, actually calculating the APR and knowing when it is permissible to use estimates is also confusing to bankers that work with these issues every day. Explaining them to customers that are not as familiar with banking is not easy and may actually be more confusing to customers. This process desperately needs simplification so that *all* consumers can understand the APR. These calculations are especially frustrating in an increasingly competitive environment where non-depositories use sleight-of-hand to exclude certain items from the APR (bankers often point to auto dealers' advertisement of 0% APRs, as noted above). The regulation and disclosures ought to be tested against focus groups made up of average consumers and revised until easily understood by consumers.

New or Revised Disclosures. Once initial disclosures have been provided, there may be a lapse in time between loan approval and loan closing, especially for real estate loans. As a result, there can be changes in the structure of the final loan, and is not always clear when these changes mandate new disclosures. Similarly, it is not always clear when a change in an existing account relationship, as with a credit card account, requires a change-in-terms notice. Clearer rules or guidance on when new disclosures must be made is needed.

Real Estate Loans. Real estate loans create their own additional problems under Regulation Z. For example, the requirements for the early disclosures under Regulation Z are not in synch with the requirements under

HUD's RESPA requirements, and yet the banker should beware who does not get it right. The requirements should be coordinated.

Many consumers complain about the volume of documents required for real estate loan closings, and the volume and extent of disclosures has gotten so extensive as to provide little meaningful information. If a simplification process is to succeed, one set of coordinated rules for real estate loans is needed – not a variety of regulations issued by different agencies.

Real estate mortgage transaction disclosures should be simple and easy to understand, clearly specifying the obligations and responsibilities of all parties. Disclosures should focus on the information consumers want most: the principal amount of the loan, the simple interest rate on the promissory note, the amount of the monthly payment and the costs to close the loan. Information should be provided to consumers at the appropriate stage of a transaction to allow them to make informed decisions. One set of rules should govern all mortgage lenders, and regulation, supervision and enforcement must be consistent across the industry. And much better supervision of non-depository lenders is needed.

Credit Card Loans. For credit card loans, the requirements under Regulation Z and Regulation E (Electronic Funds Transfers) should be reconciled. Instead of two different regulations, it would be easier if the Federal Reserve established one regulation for credit cards that covered all requirements. In addition, regulatory restrictions requiring resolution of billing-errors within the given and limited timeframes are not always practical. The timeframes should be expanded to allow banks to investigate and resolve errors. Moreover, the rules for resolving billing-errors are heavily weighted in favor of the consumer, making banks increasingly subject to fraud as individuals learn how to game the system, even going so far as to do so to avoid legitimate bills at the expense of the bank. There should be increased penalties for frivolous claims and more responsibility expected of consumers.

Restitution. Recognizing the complexity of the disclosure requirements, if there have been inadvertent errors by the bank in making disclosures, greater flexibility should be allowed so banks do not have to review large numbers of consumer files and possibly make restitution of only a few cents: the costs for such actions certainly far outweigh the minimal benefits to the individual consumer.

Equal Credit Opportunity Act (Federal Reserve Regulation B)

Regulation B creates a number of compliance problems and burdens for banks. Knowing when an application has taken place is often difficult because the line between an inquiry and an application is not clearly defined. To answer customer questions about loan products, bankers must have sufficient information to respond correctly, and yet having too much information can lead to

an "application" that triggers additional responsibilities on the part of the bank. While bankers want to provide customer service, the regulations make it difficult, and almost mandate a written application in all instances. This should be rationalized to reflect modern technologies and to prevent barriers to customer service.

Spousal Signature. A related issue that creates problems for all creditors is the issue of when to require the signature of a spouse. This can be especially problematic for small business loans when the principal of the business and his or her spouse guarantee the loan. Instead of allowing banks to accommodate customer needs and provide customer service, the requirements make it difficult and almost require that all parties – and their spouses – come into the bank personally to fill out the application documents. This makes little sense as the world moves toward new technologies that do not require physical presence to apply for a loan.

Adverse Action Notices. Adverse action notices present another problem—one that promises to be aggravated by new requirements under the Fair and Accurate Credit Transactions (FACT) Act. It would be preferable if banks could work with customers and offer them alternative loan products if they do not qualify for the type of loan for which they originally applied. However, doing so may trigger requirements to supply adverse action notices. And knowing when to send an adverse action notice is not always readily determined. For example, it may be difficult to decide whether an application is truly incomplete or whether it can be considered "withdrawn."

Moreover, the requirements for adverse action notices under Regulation B are not always in synch with the requirements under the Fair Credit Reporting Act (FCRA). And, while there may be more than one reason that the loan was denied, determining what reason to provide on the adverse action notice form may not be simple. A simple straightforward rule on when an adverse action notice must be sent – that can easily be understood – should be developed.

The real danger is that regulatory complications could make it much easier for banks to deny an application instead of working with customers to find a suitable loan product. In such cases, it will be low- and middle-income loan applicants or those that are marginal or have problem credit histories that will be most negatively affected.

Other Issues. Regulation B's requirements also complicate other aspects of customer relations. For example, to offer special accounts for seniors, a bank is limited by restrictions in the regulation. And, most important, reconciling the regulation's requirements not to maintain information on the gender or race of a borrower and the need to maintain sufficient information to identify a customer under section 326 of the USA PATRIOT Act is difficult and needs better regulatory guidance.

Home Mortgage Disclosure Act (HMDA) (Federal Reserve Regulation C)

Exemptions. The HMDA requirements are the one area under Part 2 of the current EGRPRA regulatory review (consumer lending regulations) that does not provide specific protections for individual consumers. Rather, HMDA is primarily a data-collection and reporting requirement and therefore lends itself much more to a tiered regulatory requirement that places fewer burdens on smaller institutions. The current exemption for banks with less than $33 million in assets is far too low and does not make sense in today's banking environment, especially when there are banks with $1 *trillion* in assets. The HMDA exemption should be increased to at least $250 million, if not higher.

A second problem is the definition of an MSA (metropolitan statistical area). Since the definition of an MSA also determines which banks must report under HMDA, the banking agencies should develop a definition that applies to banks. Instead, banks are subject to a definition created by the Census Bureau for entirely different reasons. As a result, banks in rural areas and that should not be covered by HMDA reporting requirements may be captured by rules that do not reflect the reality of banking. Although the ICBA has often been a proponent of consistency in regulatory definitions, HMDA reporting requirements should be developed by the banking agencies and not subject to rules developed by other agencies that are establishing definitions for completely different criteria.

Volume of Data Required. For banks that are subject to HMDA requirements, the volume of the data that must be collected and reported is clearly burdensome, and has been identified by bankers as one of the top ten regulatory burdens. Consumer activists are constantly clamoring for additional data, and the recent regulatory changes requiring collection and reporting of yet more data succumb to their demands without a clear cost-benefit analysis. All consumers ultimately pay for the data collection and reporting. Moreover, collecting some of the information, such as data on race and ethnicity, can be offensive to some customers who hold the bank responsible. Clearly, better cost-benefit analysis is needed in assessing the volume of data required under HMDA, with clear demonstration of the utility that justifies the costs involved.

Specific data collection requirements are difficult to apply in practice and therefore add to regulatory burden and the potential for error. Bankers report expending precious resources to constantly review and revise the HMDA data to ensure accurate reporting. Some of these problems are:

- Knowing which loans are refinancings
- Assessing loans against HOEPA (the Home Owners Equity Protection Act)
- Determining the date the interest rate on a loan was set

- Comparing Treasury yields against loan rates when maturity of loan does not match existing Treasury securities
- Determining physical property address or census tract information in rural areas
- Determining lien status (first, second, third)
- Coordinating reasons for denial with requirements for Reg B adverse action notice
- Constant review and updating of information collected for reporting

These problems should be addressed, whenever possible by eliminating the data requirement, and regulatory guidance in this area should be clear and easily applied. The current complexity and difficulty in applying existing guidance to daily operations merely adds to the level of burden and cost.

Finally, bankers report encountering conflicts between the data required under HMDA and the data that must be collected and reported under ECOA. The two data collection requirements should be reconciled and coordinated so that there is only one set of data-collection rules that apply to the race, age, ethnicity and gender of borrowers.

Flood Insurance

Flood insurance is another one of the top ten regulatory problems identified by bankers. The current flood insurance regulations create difficulties with customers, who often do not understand why flood insurance is required and that the federal government – not the bank - imposes the requirement. The government needs to do a better job of educating consumers to the reasons and requirements of flood hazard insurance.

For bankers, it is often difficult to assess whether a particular property is located in a flood hazard zone since flood maps are not easily accessible and are not always current. Even once a property has been identified as subject to flood insurance requirements, the regulations make it difficult to determine the proper amount, and customers do not understand the relationship between property value, loan amount and flood insurance level. Once flood insurance is in place, it can be difficult and costly to ensure that the coverage is kept current and at proper levels. As a result, many banks rely on third party vendors to assist in this process, but that adds costs to the loan. Flood insurance requirements should be streamlined and simplified to be understandable.

Bank Secrecy Act (BSA) and Anti-Money Laundering (AML) compliance

Of special concern to ICBA member banks are the requirements and costs associated with filing currency transaction reports (CTRs), especially when weighed against the lack of evidence that they provide useful information. Bankers believe that law enforcement has a tendency to shift costs and burdens

to the banking industry and therefore ignores the costs. Bankers are concerned with potential conflicts between anti-discrimination laws and customer identification requirements under the USA PATRIOT Act. And, although guidance has begun to appear, bankers are concerned with the overall lack of regulatory guidance, especially on practical issues such as retention of copies of a customer's driver's license.

Another problem under Patriot Act compliance is the data-match program that requires banks to search records for possible matches to lists furnished by the government every two weeks. And, related to BSA, bankers complain about the difficulty of using lists issued by the Office of Foreign Asset Control (OFAC).

Bankers are willing to take the necessary steps to do their part to combat money laundering and terrorist financing. However, there is a critical need for better communication from law enforcement about the success of existing bank efforts and guidance on what to look for to help detect illicit activities. There is a need for a true partnership between law enforcement and banks – but so far, banks feel that all the effort has been on the bank side. Perhaps more important, though, is the need to recognize that banks have limited resources. For example, the time and effort expended in filing currency transaction reports consumes resources not available to combat other types of fraud or to serve customers. These requirements must be balanced, and law enforcement should not view banks as having limitless resources to comply with these demands.

There is another important point that must be recognized. As the costs associated with compliance increase, the costs for offering simple checking and savings accounts also increase. These fees are ultimately passed along to consumers. This point is especially important in the anti-money laundering context because as these fees increase, they drive more and more potential customers away from banks. The Treasury Department has stressed the need to bring the nearly 10 million "unbanked" customers into the banking system. However, by increasing costs and driving customers away, it creates a fertile environment for underground banking systems. If a transaction is conducted through a regulated and highly supervised depository, law enforcement has access to the information. But driving consumers away from banks helps create systems where that information may not be as readily accessible.

Money Market Deposit Accounts (Federal Reserve Regulation D)

ICBA members have suggested that the current limit on transfers from MMDAs is an anachronism in today's environment that puts banks at a competitive disadvantage to brokerage firms and credit unions. This is especially true for smaller banks that cannot afford the costs that would allow them to offer sweep services. ICBA supports expanding the number of transfers for money market deposit accounts.

Privacy Notices

Many community bankers view the annual privacy notice as ineffective. Banks that do not share information other than as permitted under one of the exceptions should have the option not to deliver the annual notice unless there has been a change in their privacy policy, a step that would make it more likely consumers would pay attention to the notices. For banks that do not share information, a short statement to that effect printed on a customer's bank statement should be sufficient. As a general rule, a privacy notice should only be required at account opening and when a bank's privacy policy or practices change. The current requirement that banks furnish all customers with an annual privacy notice actually has a very serious unintended consequence: it encourages customers to disregard the information that is provided, making them increasingly less likely to pay heed to notices.

Call Reports

The volume and extent of information that must be reported for the call report is extensive and very time consuming for banks to prepare. Although software programs are helpful, many community banks report they must make manual adjustments to provide information in the format requested. Banks also question the volume of information requested and whether it is all truly meaningful or necessary. Bankers appreciate the steps being taken to overhaul the process, but believe more could be done. Unfortunately, it seems that once any particular bit of data is requested on the call report, it never goes away, even though the need for the information or the rationale for requesting it may have long expired.

Credit to Insiders (Federal Reserve Regulation O)

Bankers feel that the many disclosures required for loans to insiders, especially board members, invades privacy. More important, it drives good customers away by forcing insiders to go elsewhere for loans. The restrictions also make it difficult for bankers to attract qualified individuals to the board of directors.

Expedited Funds Availability (Federal Reserve Regulation CC)

The current funds availability schedule increases the potential for fraud loss for banks. Bankers also report that the costs and burdens associated with placing extended holds reduce their usefulness. Especially problematic is next-day availability for cashier's checks that are becoming increasingly subject to counterfeiting.

Examinations

The need for consistency among agencies, coordination of examinations and better training for examiners are critical. Bankers also stress the need to distinguish between different banks in different markets in the examination process.

Testimony of

America's Community Bankers

on

Cutting Through the Red Tape: Regulatory Relief for America's Community-Based Banks

before the

Subcommittee on Financial Institutions and Consumer Credit

of the

Financial Services Committee

of the

United States House of Representatives

on
May 12, 2004

Mark E. Macomber
President and CEO
Litchfield Bancorp
Litchfield, Connecticut

and

Member, Board of Directors
Chairman, Committee on Mutual Institutions
Member, Government Affairs Steering Committee
America's Community Bankers
Washington, DC

Mr. Chairman and Members of the Subcommittee, I am Mark Macomber, President and CEO of Litchfield Bancorp in Litchfield, Connecticut. Litchfield Bancorp is a $162 million state chartered community bank, part of a two bank mutual holding company.

I am here this morning representing America's Community Bankers (ACB). I serve on ACB's Board of Directors and Executive Committee and am Chairman of the Mutual Institutions Committee. ACB is pleased to have this opportunity to discuss with the subcommittee recommendations to further reduce the regulatory burden and red tape on community banks. And in turn, community banks will be able to better serve consumers and small businesses in their local markets. ACB has a long-standing position on reduction of regulatory burden. Community banks today operate under a regulatory scheme that becomes more and more burdensome every year.

In addition to the regulations imposed on community banks to ensure safe and sound operation of the bank and to protect the deposit insurance fund, we must comply with an array of consumer compliance regulations. These regulations serve a useful purpose but in many cases the regulatory burden of compliance and preparation and delivery of disclosures outweighs the benefits. In the past ten years, a number of very burdensome regulations have been layered on to an already heavy burden. In just the past three years, significant burden has been added by the enactment of the USA Patriot Act and the Sarbanes Oxley Act. As a community banker, I understand the importance of tracking and eliminating terrorist financing mechanisms and also of having a strong corporate governance system in place. As a community banker, I see how much it costs, both financially and in numbers of staff hours for my small mutual community bank to comply with just these two laws. As a community banker, I see projects that will not get funded, products not offered and consumers not served because I have had to make a large resource commitment to comply with the same regulations with which banks thousands of times larger must comply.

This hearing and this topic are important and timely. Ten years ago there were 12,000 banks in the US. Today, there are almost 9,000 of us left. ACB is concerned that community banks are unable to compete with financial services conglomerates and unregulated companies because of the cost of regulation. Community banks are at the heart of cities and towns everywhere and to lose that segment of the industry because of over regulation would be a shame.

I have several recommendations to relieve regulatory burden and red tape, but I would be remiss Chairman Bachus, if I first did not thank you and the members of the House Financial Services Committee, as well as the full Chamber for passing H.R. 1375, the Financial Services Regulatory Relief Act of 2004. We appreciate your hard work in this area. In passing H.R. 1375, the House moved to reduce regulation on community banks in dozens of ways, three of which are particularly important: First, you removed unnecessary restrictions on branching in Section 401, allowing community banks to have flexible branching authority. Second, you provided parity for savings associations in Section 201, permitting them to engage in trust activities in the same manner as banks. And third, the bill provided savings associations full small business lending authority, as well as an increase in their lending limit on other business loans from 10 to 20 percent of assets. A very good start! We have urged the Senate to take up H.R. 1375 and make the first round of reg relief a reality this year.

Now let me turn to the subject of today's hearing.

ACB and its members strongly believe that there is more to being a community bank than just banking. For example, Litchfield Bancorp participates in, and contributes to, financial literacy programs, performing arts initiatives, local sports programs, and numerous charitable organizations. In fact, ACB did a poll of its members last year and found that half of our community bank presidents and CEOs volunteer 11 hours or more per month to non-profits and other local organizations. And 90 percent of our Members support 10 or more nonprofit groups each year. So there is more to community banking than just the business of banking. We provide critical resources, financial and personal, to making our communities better places to live.

ACB has several recommendations to further reduce regulations on community banks that will help make doing business easier and less costly, further enabling community banks to help their communities prosper and create jobs.

H.R. 3952 (the Promoting Community Investment Act)

First, ACB strongly supports passage of H.R. 3952, the Promoting Community Investment Act, sponsored by Congressman Jeb Hensarling. Mr. Hensarling's bill will allow community banks with less than $1 billion dollars in assets to participate in the Community Reinvestment Act (CRA) small institution examination. According to a report by the Congressional Research Service, a community bank participating in the streamlined CRA exam can save 40 percent in compliance costs! By passing H.R. 3952, you will free up capital and other resources for almost 1,700 community banks across our nation that are in the $250 million to $1 billion asset-size range, allowing them to invest even more into their local communities.

In addition to allowing banks with up to $1 billion in assets to use the streamlined CRA exam, ACB welcomes a review of the current examination procedures and guidance as a means to critically assess the issues that are highlighted in a debate of Internet banking, nationwide operations, assessment area, expanded service offerings and other developments. The reviews should cover the following areas:

- Incentives for both large and small institutions to achieve higher ratings;
- Reduction of burdensome recordkeeping requirements for all institutions;
- Acknowledgment of the use of alternative delivery systems by all institutions and a further acknowledgement of the role of technology in the fulfillment of CRA;
- Expansion of the degree of favorable consideration received by institutions for out-of-assessment-area provision of lending and other financial services; and
- Provisions for banks facing difficulty obtaining necessary CRA credit as a result of abnormal competition for CRA credits in their assessment areas.

We believe that raising the threshold for the definition of small bank will reduce the regulatory burden for those institutions between $250 million in assets and $1 billion in assets without diminishing the activities of community banks or their CRA obligations. The goals of the

Community Reinvestment Act are laudable and I take them seriously but as a community banker I would not be in business if I did not meet the credit needs of all aspects of my community. I do not need costly record keeping or a lengthy examination to tell me if I am doing the job.

Subchapter S reforms

Secondly, ACB supports passage of legislation to reform Subchapter S of the Internal Revenue Code.

Although not within the jurisdiction of this committee, we urge you to convey support to the leadership of the House Ways and Means Committee. The legislation should include several provisions: 1) increase the number of shareholders of community banks who are eligible to form a Subchapter S corporation from 75 to 200; 2) permit IRA's to be eligible shareholders; 3) clarify that interest on investments maintained by a bank to enhance safety and soundness is not disqualifying passive income; and 4) permit bad debts to be charged off at the corporate level.

Congress made Subchapter S status available to insured depositories for the first time in 1996, but many existing institutions have been unable to make the election because a corporation is not eligible if it has more than 75 shareholders.

Subchapter S of the Internal Revenue Code was first enacted in 1958 to eliminate the double taxation on the profits of small corporations. In effect, small corporations became subject to a method of taxation similar to that imposed on partnerships.

Because of recent false rhetoric, I hasten to add that the shareholders of Subchapter S banks are fully taxed on corporate profits.

Taxes

And speaking of taxes, I have to mention that a primary burden for many community banks is that they pay taxes but compete against a new breed of credit unions that operate as full service banks that do not pay taxes to support federal, state or local governments. ACB recognizes that this is not a tax-writing committee but you hold the other shoe by controlling the expansion of credit union authorities that implicitly expands their tax advantage, and by overseeing the regulators that also are expanding authorities and the scope of the tax exemption.

The third way you can help community banks is to support Ways and Means Chairman Bill Thomas, who has proposed undertaking a review of the roles of tax-exempt institutions, and the appropriateness of maintaining tax-exempt status when they compete for profit against tax-paying companies.

In my own state, Charter Oak Federal Credit Union is a $425 million institution that offers every service my bank can provide. Their earnings last year were $4.6 million, none of it taxed. They are more than two and half times my bank's size, provide virtually identical services in a geographic area larger than that served by my own bank. By simply calling themselves a credit union and requiring a $5.00 share purchase for "members" they avoid over $1.5 million in

income taxes. They are not the mom and pop institution run by volunteers people erroneously associate with the credit union label. They are an aggressive financial services competitor subsidized by my own institution's taxes and, for that matter, by my personal taxes, and yours.

Congress must eliminate the tax-exempt status and special regulatory treatment of the new breed of complex, bank-like credit unions. Community banks pay taxes, and therefore contribute to the tax base in their local communities; providing important funds that are used for police officers and firefighters, for fixing roads, and improving our children's schools. In addition to paying taxes, bank-like credit unions should also be required to meet the same CRA requirements as banks in their markets.

Until such credit unions pay taxes and comply with CRA, the National Credit Union Administration (NCUA) should stop liberalizing its field of membership rules and should prohibit further expansion into commercial banking services. Congress should also reject proposals to give such credit unions additional powers.

Congress chartered credit unions in 1934 to serve persons of modest means. In return, credit unions were exempted from taxation. However, an October 2003 General Accounting Office (GAO) report indicates "that credit unions served a slightly lower proportion of low-and moderate-income households than banks." So in fact, community banks do a better job in serving the very consumers credit unions claim as the basis for their tax-exempt preference.

Because my bank is a mutual community bank, the taxation argument is especially significant. Mutual savings banks like mine operate in a manner very similar to credit unions. We have no stockholders, but lost our tax subsidy in 1952, and have been paying our fair share of taxes ever since. At that time, mutual institutions were deemed to be mature members of the financial services marketplace. The powers of credit unions today far exceed the powers of the mutual savings institution industry in 1952.

Over the years, two distinct credit union industries have emerged. The first group consists of credit unions that adhere to their original statutory mission. The other has expanded fields of membership, maintains extensive branch networks, and offers products virtually identical to community banks and much larger institutions. Yet, they are still exempt from taxes and the CRA. Correcting that inequity, either by taxing bank-like credit unions or giving community banks tax relief, and ensuring appropriate safety and soundness practices in bank-like credit unions, should be a high priority for Congress.

A final point that I would like to raise with regard to credit unions is one of safety and soundness. Credit unions have begun to offer products to their members and to engage in activities that are new to the institutions and are also new to the supervisors. The financial services industry has seen what a rapid expansion of products and services can mean to an industry that is not prepared for the risks. Credit unions that operate like banks should be treated like banks in every respect including taxation and supervision.

Basel II

ACB's fourth recommendation is for Congress to make sure that Basel II and its attendant capital requirements do not put community banks at a competitive disadvantage with large, international institutions. This is probably one of the most important issues facing community banks today.

ACB believes that legislators, regulators and the industry should examine and evaluate, prior to implementation, the cost and complexity of the proposed Basel II capital accord, its competitive impact on banking institutions of different sizes, and the ability of regulators to properly supervise and examine the proposed new minimum capital requirements. Any new capital accord should treat similar risks comparably from institution to institution to avoid creating competitive inequities. Regulators should consider a more simplified approach to the proposed new capital requirements so that the benefits and incentives of more risk-sensitive capital requirements are made available to all financial institutions operating in the United States. If Basel II is implemented for a portion of the banking industry, alternatives must be provided at the same time for banks operating under the Basel I structure to maintain similar capital requirements for similar risks.

The U.S. banking regulators have begun the implementation process of the Accord in the United States. The most important aspect of implementation would be that the Accord might apply only to the 10 to12 largest U.S. banking organizations that have total assets of $250 billion or more or total on-balance-sheet foreign exposure of $10 billion or more. Other institutions can opt-in to the Accord if they can meet very strict and burdensome eligibility standards. The cost and complexity of opting in does not make this a viable option for most community banks.

As a result of the planned implementation in the United States, for the first time there would be a bifurcated regulatory capital framework. This has raised concerns that the Accord will create competitive inequities between large and small banks because of, among other things, the more favorable capital treatment of mortgage and other retail lending under the Accord.

Congress must make sure community banks across the country are not adversely affected by Basel II.

Accounting Issues

There are a number of accounting issues that are currently in play, including the recently resolved accounting for loan loss reserve issue, the treatment of loan participations, and the impact of accounting changes on the capital treatment given to trust preferred securities issuances. These are just a few examples of the many issues that have arisen the past few years. In these and in other examples, ACB and community bankers are concerned that the confusion that results from the differing information received from the federal banking agencies and the accounting community, including FASB, the SEC, and the accountants themselves, results in a significant burden.

We urge Congress to work with the accounting community to recognize the significant business impact that accounting changes have on the bottom-line of community banks. The federal bank

agencies, the FASB, the SEC and others must work together to understand that disagreement among these groups only adds to the regulatory burden on community banks. They will not be able to make loans or to raise capital.

If community banks are unable to enter into participation agreements because of adverse accounting consequences or the additional added expenses of establishing special purpose entities, loans will not be made in communities by those institutions that are most likely to make them. Loans are often too large or too risky for just one community bank to make and a participation arrangement is the only solution. Many community banks have been able to raise needed capital by issuing trust preferred securities in a pooled arrangement. The uncertain capital treatment created by accounting changes is a burden and forces community banks to look elsewhere to raise capital.

Examination and Supervision

Another area that I would like to highlight is that of uncertainty in the examination and supervision area. When the Washington main offices of the federal bank agencies develop a policy or change a regulatory requirement, ACB notes that regulatory burden on community banks can be reduced if a consistent message is given to the examiners in the field and then it is transmitted to the community banks in a timely way. We hear anecdotally that examiners frequently do not have the same message that Washington has and that uncertainty is adding to the burden of community bank compliance. Further, the vast number of regulatory issuances should be reviewed. Continuous release of information that must be absorbed by the small staffs of community banks is another example of regulatory burden. ACB does not mean to suggest that regulations and policies necessary for safety and soundness should not be issued, but the message should be consistent and easily understandable.

Finally, ACB believes that the fees charged for examinations should be rational and based on work done. In addition, we continue to believe that state non-member banks should not be required to pay examination fees to the FDIC. The imposition of these additional fees reduces the amount of resources available to the community.

Unnecessary and redundant privacy notices

And lastly, ACB urges you to review the rules that require community banks to send multiple privacy notices. We suggest that required annual privacy notices for banks that do not share information with nonaffiliated third parties should be eliminated. Banks with limited information sharing practices should be allowed to provide customers with an initial notice, and provide subsequent notices only when terms are modified.

I am sure you are all inundated by privacy statements each fall. I am equally confident that most or all of them remain unread. At my bank we send out thousands of such notices each year at significant cost, in both dollars and staff time, even though our policies and procedures have remained consistent over many years. Redundancy in this case does not enhance consumer protection, rather it serves to numb our customers with volume.

I will tell you, community banks guard their depositors' information like Fort Knox and have built their reputations on the trust of their customers that their bank will actually do so. Most community banks do not share information in any way whatsoever. Others share information only under very controlled circumstances when certain operational functions are outsourced to a vendor. The requirement to send notices should be amended when circumstances have not changed or when we are only reiterating that no customer information is ever shared. We do agree a notice should be sent, but it becomes an expensive burden to send it multiple times when once will more than suffice.

Conclusion

I wish to again express ACB's appreciation for your invitation to testify on the importance of cutting red tape for community banks. We strongly support the Committee's efforts in providing regulatory relief, and look forward to working with you and your staff in crafting legislation to further accomplish this goal.

STATEMENT OF

JOHN M. REICH
VICE CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION

on

THE IMPACT OF REGULATORY BURDEN ON AMERICA'S COMMUNITY-BASED BANKS

before the

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT

of the

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

May 12, 2004 -- 10:00 AM
2128 Rayburn House Office Building

Mr. Chairman, Ranking Member Sanders, and Members of the Subcommittee, I very much appreciate this opportunity to testify on the impact of regulatory burden on community banks. As a former community banker with 23 years of experience in the industry, and as the current leader of an inter-agency effort to reduce regulatory burden, I have a strong commitment to eliminate unnecessary burden while maintaining the safety and soundness of the industry and protecting important consumer rights.

After describing the vital importance of community banks, my testimony will highlight the burden imposed by banking regulations and the impact those regulations have on community banks. Next, I will outline our efforts to review our regulations and address, on an inter-agency basis, some of the existing regulatory burden, as well as the actions the Federal Deposit Insurance Corporation is taking unilaterally to reduce burdens imposed by our own regulations and operating procedures. Finally, I will discuss the need for legislative action to reduce burden.

The Role of Community Banks

As Chairman Bachus noted in a recently-introduced House Resolution, community banks play a vital role in the economic wellbeing of countless individuals, neighborhoods, businesses and organizations throughout our country, often serving as the lifeblood of their communities. The definition of a community bank is somewhat fluid, but generally it is viewed as a financial institution with assets up to $1 billion that is associated closely with the community where it is located. I will use that as a working definition for community banks overall today, while paying special attention to small community banks (those with less than $100 million in assets).

These banks are found in all communities—urban, suburban, rural and small towns. Whether a minority-owned urban neighborhood institution or an agricultural bank, community banks have several things in common. They are a major source of local credit. Data from June 2003 show that the overwhelming share of commercial loans at small community banks was made to small businesses. In addition, the data indicate that commercial banks with assets between $100 million and $1 billion account for a large share of all small business and small farm loans.

Community banks are the bankers for municipalities and school districts. Community bankers generally know personally many small business owners and establish lending relationships with these individuals and their businesses. These small businesses, in turn, provide the majority of new jobs in our economy. Small businesses with fewer than 500 employees account for approximately three-quarters of all new jobs created every year in this country.

More importantly, these banks also are an interdependent part of the entire local community. The close relationship of the bank and the local community has many tangible and intangible benefits. Recently, a community banker who is also a member of the FDIC's Advisory Committee spoke about her small bank and its relationship to the community. Terry Jorde is President and CEO of CountryBank USA, a $37 million community bank with two offices in Cando and Devils Lake, North Dakota. Here's what Terry Jorde had to say about the role of her bank and her bank's commitment to their community:

> Local banks that fund local businesses are particularly attuned to the needs of their communities and are uniquely equipped to facilitate the local economic development process, which can be time-consuming and resource-intensive. Community bankers provide tremendous leadership in their communities, which

> is critical to economic development and community revitalization. For example, in a recent week I spent six hours in a hospital board meeting, four hours in an economic development corporation meeting, and another four hours working with other local community bankers to develop a financial incentive package for a potential new business in our community. You could argue that this is not an efficient and cost-effective way to spend my time, but like most community banks, the very survival of my bank depends on the economic vitality of my community. I have a very real incentive to work to assure the success of Cando and Devils Lake.

The loss of community institutions can result in losses of civic leadership, charitable contributions, and local investment in school and other municipal debt.

THE PROLIFERATION OF REGULATIONS AND THEIR IMPACT ON COMMUNITY BANKS

Regulatory burden is an issue for all banks. Since enactment of the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) in 1989, the banking and thrift regulatory agencies have promulgated a total of 801 final rules. There were good and sufficient reasons for many of these rules and, in fact, some were actually sought by the industry. However, 801 regulatory changes over a 15 year period is certainly a lot for banks to digest, particularly smaller community banks with limited staff. Rule changes can be quite costly since implementation often requires computers to be reprogrammed, staff retrained, manuals updated and new forms produced. Even if some of the rules do not apply to a particular institution, someone has to at least read the rules and make that determination.

There are no definitive studies of the total cost of regulation. However, a survey of the evidence by a Federal Reserve Board economist in 1998 found that total regulatory costs account for 12 to 13 percent of noninterest expense, or about $36 billion in 2003. For the banking industry, every change in reporting requirements or modification of

business practices involves new capital expenditures and increased human resources, computer programming costs and vendor expenses. The same research indicates that start up costs for new or changing regulations may be very expensive and insensitive to the size of the changes. In other words, the process of learning about and adopting regulatory changes is expensive, whatever the magnitude of the change. Frequent small, incremental changes may be much more expensive than large, one time changes.

New regulations have a greater impact on some community banks, especially small community banks (under $100 million in assets), than on larger institutions due to their inability to spread start up and implementation costs over a large number of transactions. Economies of scale associated with regulatory compliance have been confirmed in implementation cost studies of the Truth in Savings Act, the Equal Credit Opportunity Act and the Electronic Funds Transfer Act, where the incremental cost of regulation declines as the number of transactions or accounts rise. Jim Hance, Vice Chairman of Bank of America, summed the situation up at a recent conference at the Federal Reserve Bank of Chicago: "[A]ll banks are being mandated to install more and more compliance-related technology—for issues ranging from anti-money laundering to Basel II. Scale allows us to do so far more efficiently than smaller competitors."

My concern is that the volume and complexity of existing banking regulations, coupled with new laws and regulations, may ultimately threaten the survival of our community banks. This concern is not new. The conclusion of the 1998 Federal Reserve study states

> Average compliance costs for regulations are substantially greater for banks at low levels of output than for banks at high levels of output. This conclusion has important implications. Higher average regulatory costs at low levels of output

> may inhibit the entry of new firms into banking or may stimulate consolidation of the industry into fewer, larger banks.

Over the last 20 years, there has been substantial consolidation in the banking industry. This can be seen most dramatically in small community banks. At the beginning of 1985, there were 11,780 small community banks with assets of less than $100 million in today's dollars. At yearend 2003, their number had dropped by 63 percent to just 4,390 (see Chart 1). Even more dramatically, the total market share of those institutions decreased from nine percent at the beginning of 1985 to two percent at yearend 2003 (see Charts 2 and 3). The decline had three main components: mergers, growth out of the community bank category, and failures. The decrease was offset somewhat by the creation of 2,403 new banks. In this calculation, a community bank is defined as a bank or thrift holding company or an independent bank or thrift, and bank asset size was adjusted for inflation. Thus, a bank with $100 million in assets today is compared with one having about $64 million in assets in 1985.

A number of other market forces, such as interstate banking and changes to state branching laws have affected the consolidation of the banking industry. The bank and thrift crisis of the 1980s and the resulting large number of failures and mergers among small institutions serving neighboring communities also contributed to the decline in the smallest financial institutions. It is probable that together those factors were the greatest factors in reducing small bank numbers. However, I believe that in looking to the future, regulatory burden will play an increasingly significant role in shaping the industry and the number and viability of community banks. While many new banks have been created in the past two decades, I fear that, left unchecked, regulatory burden may eventually pose a barrier to the creation of new banks. Keeping barriers to the entry of new banks

low is critical to ensuring that small business and consumer wants and needs are met, especially as bank mergers continue to reduce options in some local markets.

It may seem a paradox to discuss profitability concerns at a time when the banking industry is reporting record earnings. Last year the industry as a whole earned a record $120.6 billion, surpassing the previous annual record of $105.1 billion set in 2002. When you look behind the numbers, however, you see a considerable disparity in the earnings picture between the largest and smallest banks in the country. The 110 largest banks in the country (those with assets over $10 billion), which represent 1.2 percent of the total number of insured institutions, earned $87.7 billion or about 73 percent of total industry earnings, while the 4,390 banks with assets under $100 million, which represent 48 percent of the total number of insured institutions, earned about $2.1 billion, which represents only 1.7 percent of total industry earnings (see Chart 4). Moreover, when you further examine the data, you find that banks with assets over $100 million had an average ROA of 1.42 percent, while those with assets under $100 million had an average ROA of 0.95 percent (see Chart 5).

While the banks under $100 million had the highest yield on earning assets (5.87 percent) they also had the lowest non-interest income (1.43 percent), and the highest noninterest expense to asset ratio (3.71 percent). This combination resulted in about *1 in 10 banks* under $100 million in assets being unprofitable in 2003. This is over five to six times the ratio for banks between $100 million and $10 billion and almost ten times greater than the largest banks. These numbers make it clear that community banks, while healthy in terms of their supervisory ratings, are operating at a lower level of profitability than the largest banks in the country. At least part of this disparity in earnings stems

from the disproportionate impact that regulations and other fixed noninterest costs have on community banks (see Chart 6).

Community bankers have told me that regulatory burden is often a factor in their decisions to sell or merge their banks and that the cost of compliance with accumulated regulation is taking its toll. Recently, I spoke to a group of 100 community bankers from Florida, and asked for a show of hands as to how many bankers felt that the increasing cost of compliance and regulatory burden might be a factor in trying to decide whether to remain independent or to seek a merger partner. About 40 percent raised their hands and, although this was certainly not a scientific survey in any respect, it was consistent with what I have heard over the past year as community bankers have expressed growing frustration with the time, effort, and resources it takes to comply with bank regulation today. Bankers are becoming increasingly worried that their institutions—and all that they mean to their communities—may not be able to operate at an acceptable level of profitability for their investors for too many more years under what they describe as a "never-ending avalanche" of regulations.

In some cases, the cost of complying with that burden is pushing some smaller banks out of the market. One bank CEO of a consistently high performing community bank confided that at a recent meeting of his bank's board, the institution's directors remarked that the bank's return on assets had been slipping in recent years, in part attributable to the increasing costs of compliance, and asked how much longer the bank can afford to remain independent without giving consideration to maximizing current shareholder value through a merger or sale. These conversations are likely occurring in community bank boardrooms all over the United States today.

An additional challenge community bankers face is maintaining the capacity to respond to the steady stream of new regulations while continuing to comply with existing regulations. Some of the new regulations and reporting requirements facing the industry include those required by the FACT Act legislation enacted by Congress last year, USA PATRIOT Act, the Sarbanes-Oxley Act, and the Check 21 Act. These laws reflect important public policy choices concerning the quality of the credit reporting system, identity theft, national security and changes in technology. However, it is incumbent upon the regulators who write implementing regulations, as well as the Congress, to be ever mindful of the need to avoid unnecessarily increasing regulatory burdens on the industry as we implement new reporting requirements and regulations required by legislation.

It is not just the total volume of regulatory requirements that pose problems for the future, but also the relative distribution of regulatory burden across various industries that could hit community banks hard in the future. For example, community bankers are increasingly subject to more intense competition from credit unions, which have, in many cases, evolved from small niche players to full-service retail depository institutions. In the past ten years, the number of credit unions with assets exceeding $1 billion has increased four-fold, from 20 institutions in 1994 to 83 institutions today and the credit union industry continues to grow nationwide. With ever-expanding fields of membership and banking products, credit unions are now competing head-to-head with banks and thrifts in many communities, yet the conditions under which this competition exists enable credit unions to operate with a number of advantages over banks and thrifts. These advantages include exemption from taxation, not being subject to the Community

Reinvestment Act, and operation under a regulatory framework that has supported and encouraged the growth of the credit union movement, including broadening the "field of membership." These advantages make for an uneven playing field, a condition that Congress should reexamine and seek to resolve.

I am a strong proponent of market forces determining economic outcomes. If community banks lose out in a fair and square competition with credit unions or larger banks, so be it – let the market speak and the chips fall where they may. But if smaller banks will be weakened in the market not by competition or technology, but inadvertently or unintentionally by the disproportionate effect of regulatory burden, and by competition from financial institutions not subject to the same regulations, that outcome seems to be inequitable and unacceptable. We need to think about the appropriate public policy response to prevent this outcome.

As you can tell, I have some serious concerns about the future of community banking, and I see regulatory burden as an important factor in the equation for their future success. I personally believe the stakes are high for community bankers in this fight to reduce regulatory burden, and the very future of community banking may well depend on the success of our efforts.

INTER-AGENCY EFFORT TO REDUCE REGULATORY BURDEN

In 1996, Congress passed the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA). Section 2222 of EGRPRA requires the Federal Financial Institutions Examination Council (FFIEC) and each of its member agencies to review their regulations at least once every ten years, in an effort to eliminate any regulatory

requirements that are outdated, unnecessary or unduly burdensome. Last year, FDIC Chairman Don Powell, as Chairman of the FFIEC, asked me to oversee this inter-agency effort. I accepted with enthusiasm.

From the beginning of this process, each of the agency principals—FDIC Chairman Powell, Comptroller Hawke, OTS Director Gilleran, Federal Reserve Governor Bies, and NCUA Chairman Dollar—have given their full support. We also have received enthusiastic cooperation and support from the Conference of State Bank Supervisors and the national and state trade associations in working towards regulatory burden relief. We established an inter-agency EGRPRA task force consisting of senior level staff from the Federal Reserve Board (FRB), Office of the Comptroller of the Currency (OCC), Office of Thrift Supervision (OTS), National Credit Union Administration (NCUA), and the FDIC. Under the EGRPRA statute, the agencies are required to categorize their regulations by type (such as "safety and soundness" or "consumer protection" rules) and then publish each category for public comment. The inter-agency task force divided the agencies' regulations into the following 12 categories (listed alphabetically):

- Applications and Reporting
- Banking Operations
- Capital
- Community Reinvestment Act
- Consumer Protection
- Directors, Officers and Employees
- International Operations
- Money Laundering
- Powers and Activities
- Rules of Procedure
- Safety and Soundness and
- Securities

The agencies agreed to put one or more categories out for public comment every six months, with 90-day comment periods, for the remainder of the review period (which

ends in September, 2006). Spreading out comments over three years will provide sufficient time for the industry, consumer groups, the public and other interested parties to provide meaningful comments on our regulations, and for the agencies to carefully consider all recommendations.

The agencies published their first joint EGRPRA Federal Register notice on June 16, 2003 for a 90-day comment period, seeking comment on our overall regulatory review plan, including the way in which we categorized the regulations. The first notice also requested burden reduction recommendations on the initial three categories of regulations: Applications and Reporting; Powers and Activities and International Operations. These three categories of regulations contained 48 separate regulations for comment. In response, the agencies received 19 written comments that included more than 150 recommendations for changes to our regulations. Each of the recommendations has been carefully reviewed and analyzed by the agency staffs. Based on the recommendations, staff will now bring forward proposals to change specific regulations, as appropriate, which will be put out for public comment.

On January 20, 2004, the agencies issued their second joint request for comment under the EGRPRA program. This notice sought public comment on the lending-related consumer protection regulations, which include Truth-in-Lending (Regulation Z), Equal Credit Opportunity Act (ECOA), Home Mortgage Disclosure Act (HMDA), Fair Housing, Consumer Leasing, Flood Insurance and Unfair and Deceptive Acts and Practices. The comment period for that notice closed on April 20, 2004 and staff is currently analyzing the comment letters received to determine which recommendations to

pursue. Even though the second Federal Register notice contained far fewer regulations for comment than the initial notice, the agencies received over 550 comment letters.

Banker, consumer and public insight into these issues is critical to the success of our effort. The regulatory agencies have tried to make it as easy as possible for all interested parties to get information about the EGRPRA project and to let us know what they think are the most critical regulatory burden issues. The EGRPRA website, which can be found at www.egrpra.gov, provides an overview of the EGRPRA review process, a description of the agencies' action plan, information about our banker and consumer outreach sessions and a summary of the top regulatory burden issues cited by bankers and consumer groups. There also are direct links to the actual text of each regulation and comments can be sent to the EGRPRA website. Comments submitted through the website are automatically transmitted to all of the financial institution regulatory agencies. Comments are then posted on the EGRPRA website for everyone to see. The website has proven to be a popular source for information about the project, with thousands of hits being reported every month.

While written comments are important to the agencies' efforts to reduce regulatory burden, we believe it is also important to have face-to-face meetings with bankers and consumer group representatives so that they have an opportunity to directly communicate their views on the issues of most concern to them.

Last year, the agencies sponsored five banker outreach meetings in different cities to heighten industry awareness of the EGRPRA project. The meetings provided an opportunity for the agencies to listen to bankers' regulatory burden concerns, hear comments and suggestions, and identify possible solutions. The outreach meetings were

held over a six-month period in Orlando, St. Louis, Denver, San Francisco and New York. More than 250 bankers (mostly CEOs) as well as representatives from the national trade groups and a variety of state trade associations participated in the meetings with representatives from FDIC, FRB, OCC, OTS, CSBS and state regulatory agencies.

The banker outreach meetings were extremely useful and productive. Following panel discussions and a question and answer period, the meeting participants were broken into small discussion groups. Senior-level regulators served as moderators of the discussion groups and regulatory staff recorded bankers' concerns and their recommendations to reduce regulatory burden. Summaries of the issues raised were then posted on the EGRPRA website. Since the banker outreach meetings were so successful last year, we decided to hold at least three more meetings this year. The first one was on April 22 in Nashville, Tennessee. The next two meetings are scheduled for June 9 in Seattle, Washington and September 23 in Chicago, Illinois.

We held an outreach meeting for consumer and community groups on February 20, 2004 in Arlington, Virginia. About 24 representatives from various consumer and community groups participated in the meeting along with representatives from the FDIC, FRB, OCC, OTS and NCUA. The meeting provided a useful perspective on the effectiveness of many existing regulations. We plan to hold at least two more consumer and community group outreach meetings later this year, with tentative plans for such meetings to take place in San Francisco on June 24 and in Chicago on September 22.

Banker Comments at the Outreach Session

Bankers have made the following comments regarding a number of regulatory burden issues that they cite as being the most costly, burdensome or otherwise competitively detrimental. While this is not a scientifically selected survey of all bankers, the most frequently listed regulations and the nature of their concerns include:

Bank Secrecy Act (CTRs, SARs,): Bankers express concerns that the exemptions are overly complex and the penalties for technical noncompliance are severe. In addition, bankers say they receive no feedback on their efforts.

USA Patriot Act and Customer Identification Systems: Bankers often asked if the Customer Identification Program requirements of the USA PATRIOT Act are truly effective in combating terrorism. Again, bankers have commented regarding lack of feedback on their efforts.

Limitations on Transfers and Withdrawals from Money Market Deposit Accounts (Regulation D): Bankers believe the statutory and regulatory limits on transfers and withdrawals from money market accounts are outdated and suggest easing or repealing the limits. They also suggest eliminating existing restrictions which prohibit the payment of interest on demand deposits.

Home Mortgage Disclosure Act (HMDA) and Regulation C: Some bankers assert that the costs of complying with data collection and reporting requirements is too high in relationship to the usefulness of the data. It also was suggested that the reporting thresholds for banks be raised so that banks with less than \$50 or \$100 million in assets would be exempt from the reporting requirements.

Community Reinvestment Act (CRA) Regulations: Some bankers would like to see the asset size threshold (currently \$250 million) for the small bank CRA test raised to as much as \$1 or \$2 billion.

Privacy Act Notices: Bankers, particularly ones who do not share customer information with third parties, stated that sending annual privacy notices to all customers is costly and often confusing to the consumer.

Truth in Lending (Regulation Z) and RESPA: A number of bankers complained about the volume and complexity of documents required for closing loans and asked the agencies to reconsider the required disclosures. They also suggested simplifying Annual Percentage Rate calculations.

Truth-in Lending and the Right of Rescission: Bankers reported that few, if any customers had ever exercised their right of rescission and thus customers should be

permitted to waive their right. Alternatively, some suggested creating additional exemptions to this requirement.

Extensions of Credit to Insiders and Regulation O: Bankers reported that these lending restrictions often make it difficult to find directors willing to serve on bank boards.

Flood Insurance and the Flood Disaster Protection Act: Bankers strongly suggested that flood maps be kept up to date. Others felt that much of the cost of enforcing flood insurance requirements has shifted from the federal government to banks.

The list above includes some of the most frequently mentioned regulatory burden concerns expressed by bankers to us over the last year. The regulators are examining these concerns to determine whether suggested changes to our regulations are warranted and appropriate at this time. This process will continue until the end of the EGRPRA review process in 2006.

However, let me be clear about the Bank Secrecy Act and the USA PATRIOT Act. The FDIC is strongly committed to supervising and enforcing bank regulations to thwart and prevent terrorism. I believe this commitment is shared by the banking industry. In addition to protecting our country, it is in the best interests of a stable banking system and stable communities to be as vigilant as possible in our regulatory and supervisory efforts.

RESPONSE BY REGULATORY AGENCIES

The EGRPRA regulatory review project is still in its early stages, with approximately two years until completion. However, I am pleased to report that the banking and thrift regulatory agencies have been working together closely and harmoniously on a number of projects to address unnecessary burdens. In addition to

eliminating outdated and unnecessary regulations, the agencies have begun to identify more efficient ways of achieving important public policy goals of existing statutes. I think it is fair to say that although we have much work ahead of us, there has been significant progress to date. Here are some notable examples:

Privacy Notices

On December 30, 2003, the Federal bank, thrift and credit union regulatory agencies, in conjunction with the Federal Trade Commission, Securities and Exchange Commission, and the Commodity Futures Trading Commission, issued an Advanced Notice of Proposed Rulemaking (ANPR), seeking public comment on ways to improve the privacy notices required by the Gramm-Leach-Bliley Act. Although there are many issues raised in the ANPR, the heart of the document solicits comments on how the privacy notices could be improved to be more readable and useful to consumers, while reducing the burden on banks and other service providers required to distribute the notices. The basic idea is to develop a simpler, "short form" privacy notice (perhaps something akin to the nutrition information label on pre-packaged foods), that would be easier for consumers to understand and banks to distribute. Throughout the process of developing this ANPR, agency staff was mindful of the burden implications of changing the privacy notices and the requirements for their distribution. The regulatory agencies will be sensitive to this issue as they review and analyze the comments from the industry and consumers on this issue.

Community Reinvestment Act Regulations

On February 6, 2004, the Federal bank and thrift regulatory agencies jointly issued a proposal to amend the Community Reinvestment Act (CRA) regulations. The joint proposal would, among other things, reduce regulatory burden by changing the definition of "small institution" to mean an institution with total assets of less than $500 million, without regard to holding company assets. This represents a significant increase in the small bank threshold from the current level of $250 million which was established in the 1995. Under the proposal, just over 1,100 additional banks (those with assets between $250 and $500 million) would be subject to the small bank CRA test (the lending test) rather than the large bank test (lending, investment, and outreach tests).

This proposal would not exempt these institutions from complying with CRA—all banks, regardless of size, will be required to be thoroughly evaluated within the business context in which they operate. As I indicated at the FDIC Board meeting when this proposal was approved for publication, I think this is a good first step for the agencies. Personally, I would have liked to see the agencies propose a higher threshold, perhaps $1 billion, since I do not think any bank under $1 billion in assets should be judged by the same standards as a bank with $100 billion or $1 trillion in assets. I recognize that there are many competing interests and that community groups, in particular, generally oppose any increase at all in the threshold level. However, I think that this change to the regulation, if adopted as proposed, would result in significant regulatory burden reduction for a number of institutions without weakening the objectives of the Community Reinvestment Act. The comment period for this proposal closed on April 6, and the

agencies received more than 1,100 comment letters currently being analyzed by staff. It is my hope the agencies will consider carefully all comments and agree on a final rule before the end of this year.

RESPA

The Department of Housing and Urban Development (HUD) was, for some time, engaged in rulemaking to review and improve the process for obtaining mortgages. Given the high level of concern expressed by the banking industry about the closing process, I think it is incumbent upon the regulators to continue to play a role in the mortgage reform efforts. I agree with the basic goals of this initiative, which are to: (1) enable people to know their options so they can shop intelligently; (2) clarify and simplify the required disclosures; and (3) provide some certainty that costs won't change before closing. The FDIC has provided some input into the rulemaking process and will continue to provide whatever additional input may be necessary. I think it is important to assist in this effort to simplify and improve the closing process for consumers, while reducing unnecessary burden on the banking industry.

Bank Secrecy Act

Financial institutions and their regulators must be extremely vigilant in their efforts to implement the Bank Secrecy Act in order to thwart terrorist financing efforts and money-laundering. Last year, bankers filed over 12 million Currency Transaction Reports (CTRs) and Suspicious Activity Reports (SARs) with the Financial Crimes Enforcement Network (FinCEN). Bankers reported that they believe they are filing

millions of reports that are not utilized for any law enforcement purpose and consequently a costly burden is being carried which is providing little benefit to anyone. In an effort to address this concern, the financial institution regulatory agencies are working together with FinCEN and various law enforcement agencies, through task forces of the Bank Secrecy Act Advisory Group, to find ways to streamline reporting requirements for CTRs and SARs and make the reports that are filed more useful for law enforcement.

The need to explore better, more efficient approaches to Bank Secrecy Act compliance at financial institutions is clear. At one outreach session last year, a banker reported that it cost his bank approximately $600,000 to file 24,000 CTRs in a single year - about $25.00 per CTR. While this may not be the cost of compliance at every bank, it does remind us that as designed, the current system may not provide an efficient way of monitoring suspect cash transactions. Although bankers repeatedly express their willingness and desire to do their part to fight terrorism and prevent money laundering, it is understandable that they are concerned about the costs and other burdens associated with the current reporting system.

I am convinced that we can find ways to make this system more effective for law enforcement, while at the same time making it more cost efficient and less burdensome for bankers. I recently met with FinCEN's new Director, William Fox, and pledged to work with him to make bank reporting under the Bank Secrecy Act more effective and efficient while still meeting the important crime-fighting objectives of anti-terrorism and anti-money-laundering laws.

USA PATRIOT Act and Customer Identification Requirements

Most bankers understand the vital importance of knowing their customers and thus generally do not object to taking the additional steps necessary to verify the identity of their customers. However, bankers wanted guidance from the regulators on how they could comply with this important law. In response, the federal financial institution regulators, the Treasury Department and FinCEN issued interpretive guidance to all financial institutions to assist them in developing a Customer Identification Program (CIP), which was mandated by the USA PATRIOT Act. The inter-agency guidance answered the most frequently asked questions about the requirements of the CIP rule.

FDIC EFFORTS TO RELIEVE REGULATORY BURDEN

In addition to the above-noted inter-agency efforts to reduce regulatory burden, the FDIC, under the leadership of Chairman Powell, is constantly looking for ways to improve our operations and reduce regulatory burden, without compromising safety and soundness or undermining important consumer protections. Over the last several years, we streamlined our examination processes and procedures with an eye toward better allocating FDIC resources to areas that could ultimately pose greater risks to the insurance funds – such as problem banks, large financial institutions, high-risk lending, internal controls and fraud. Some of our recent initiatives to reduce regulatory burden can be summarized as follows:

1) Raised the threshold for well-rated, well-capitalized banks to qualify for streamlined safety and soundness examinations from $250 million to $1 billion so that the FDIC's resources are better focused on managing risk to the insurance funds;

2) Implemented more risk-focused compliance and trust examinations, placing greater emphasis on an institution's administration of its compliance and fiduciary responsibilities and less on transaction testing;

3) Increased efficiency of the IT examination procedures and streamlined IT examinations for institutions that pose the least technology risk;

4) Worked with the Conference of State Bank Supervisors (CSBS) and the Federal Reserve to develop, through a Nationwide State/Federal Supervisory Agreement, a closely coordinated supervisory system for banks that operate across state lines.

5) Initiated electronic filing of branch applications and began exploring alternatives for further streamlining the deposit insurance application process in connection with new charters and mergers;

6) Simplified the deposit insurance coverage rules for living trust accounts so that the rules are easier to understand and administer;

7) Reviewed existing Financial Institution Letters and other directives to eliminate outdated or unnecessary documents. We are also developing a more user-friendly, web-based system for finding communications from the Corporation;

8) Provided greater resources to bank directors, including the establishment of a "Director's Corner" on the FDIC website, as a one-stop site for Directors to obtain useful and practical information to assist in fulfilling their responsibilities;

9) Made it easier for banks to assist low and moderate income individuals, and obtain CRA credit for doing so, by developing Money Smart, a financial literacy curriculum and providing the MoneySmart Program free-of-charge to all insured institutions;

10) Implemented an interagency charter and federal deposit insurance application that eliminates duplicative information requests by consolidating into one uniform document, the different reporting requirements of the three regulatory agencies (FDIC, OCC and OTS);

11) Revised our internal delegations of authority to push more decision-making out to the field level to expedite decision making and provide institutions with their final Reports of Examination on an expedited basis;

12) Provided bankers with a customized version of the FDIC Electronic Deposit Insurance Estimator (EDIE), a CD-Rom and downloadable version of the

web-based EDIE, which allows bankers easier access to information to help determine the extent to which a customer's funds are insured by the FDIC.

The FDIC is aware that regulatory burden does not emanate only from statutes and regulations but often comes from internal processes and procedures. Therefore, we continually strive to improve the way we conduct our affairs, always looking for more efficient and effective ways to meet our responsibilities.

LEGISLATION TO REDUCE REGULATORY BURDEN

I wish to commend you, Mr. Chairman and your colleagues on the Subcommittee and the full Committee, for your leadership in producing H.R. 1375, The Financial Services Regulatory Relief Act. The legislation contains a number of significant regulatory relief provisions, including provisions making it easier for banks to cross state lines by opening *de novo* branches, speeding the approval process for bank mergers, eliminating certain unnecessary reports on extensions of credit to insiders, giving banks greater flexibility in the payment of dividends, increasing the exemption amount for management interlocks, removing limits for thrifts on making small business and auto loans as well as allowing regulators to adjust the examination cycles of healthy institutions when there is a safety and soundness need within the banking system for greater flexibility. The bill also includes several provisions requested by the regulators, including the FDIC, to help us do our job better and we thank the Subcommittee for including those provisions in the bill.

Over the last several months, the FDIC has been working closely with our colleagues at the FRB, OCC, OTS and NCUA in an effort to identify additional legislative proposals to reduce regulatory burden on the industry. I am pleased to report

that we are making progress in our efforts and I anticipate that we will have a proposal in the near future. Over the next several months, I will brief interested Members and their staffs on the progress of our inter-agency efforts to review our regulations and the components of our proposal for additional regulatory relief. Since most of our regulations are, in fact, mandated by statute, I believe that it is critical that the agencies work hard not only on the regulatory front, but also on the legislative front, to alert Congress to unnecessary regulatory burden. In that regard, I look forward to continuing the dialogue with Congress on regulatory relief issues.

CONCLUSION

Mr. Chairman, as you indicated at a hearing last year on H.R. 1375, banks should be able "to devote more resources to the business of lending to consumers and less to the bureaucratic maze of compliance with outdated and unnecessary regulations." I couldn't agree with you more. I believe that if we do not do something to stem the tide of ever increasing regulation, America's community banks will disappear from many of the communities that need them most. That is why I think it is incumbent upon all of us – Congress, regulators, industry and consumer groups – to work together to eliminate any outdated, unnecessary or unduly burdensome regulations. I am personally committed to accomplishing that objective.

One possible solution to the problem of ever increasing regulatory burden on community banks would be to create a two-tiered regulatory system. From both a safety-net perspective and a regulatory burden perspective, the largest banking institutions and community banks are very different, and, as a practical matter, we already have the

beginnings of a two-tiered approach to bank supervision. Community banks, for example, are examined at specific intervals while the largest institutions are examined in real time by teams of examiners that are on site every day. Once the Basel II capital standards are adopted, the largest banks will have to adhere to the new standards, while small and medium size banks will continue to be governed by the present standards.

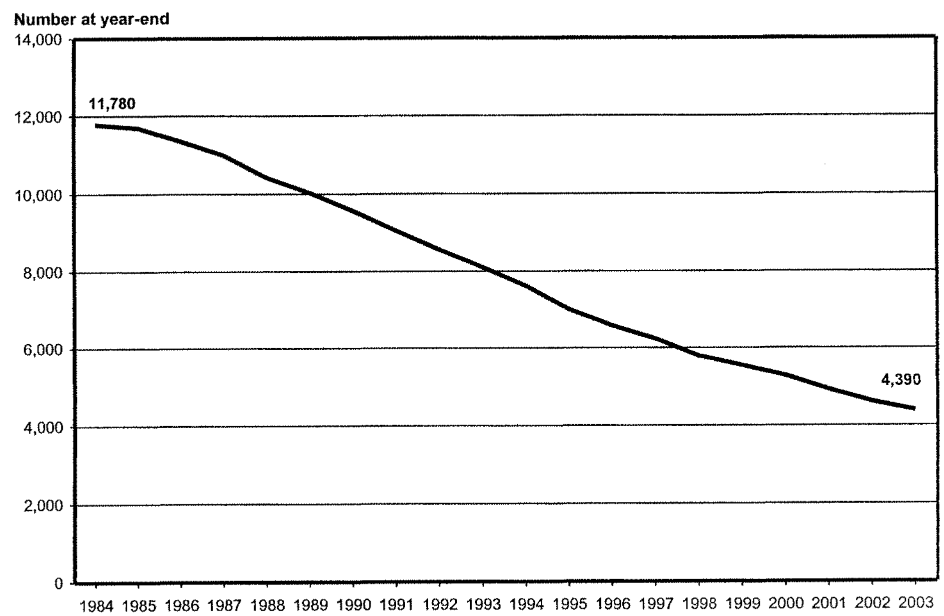
I think we need to consider ways to expand this two-tiered approach. We need to look for possible exemptions for community banks from the application of certain laws, where consistent with safety and soundness and consumer protection. We also need to look for ways to reduce the number of reports that community banks must file and reduce the complexity of the information demanded from these banks.

I am confident that, if we all work together, we can find ways to regulate that are both more effective and less burdensome, without jeopardizing the safety and soundness of the industry or weakening important consumer protections.

Thank you for providing me with this opportunity to testify here today.

Chart 1

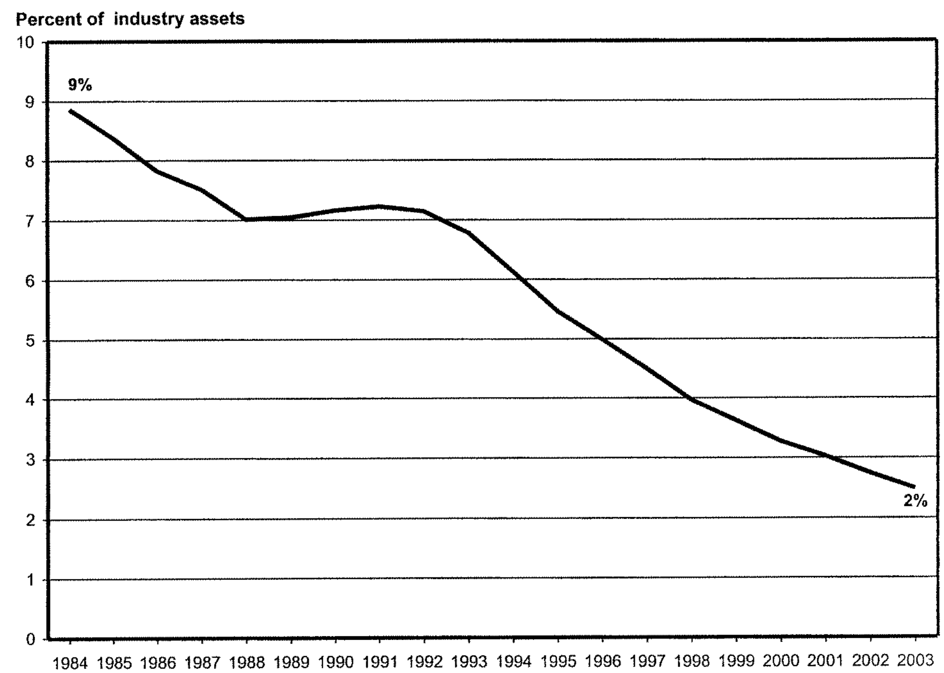
THE NUMBER OF COMMUNITY BANKS HAS BEEN DECLINING
FDIC-Insured Commercial Banks & Savings Institutions with Assets < $100 Million*



*Based on 2003 Dollars; $100MM in 2003 = $63.6MM in 1984.

Chart 2

COMMUNITY BANKS' SHARE OF INDUSTRY ASSETS CONTINUES TO FALL
FDIC-Insured Commercial Banks & Savings Institutions With Assets < $100 Million*

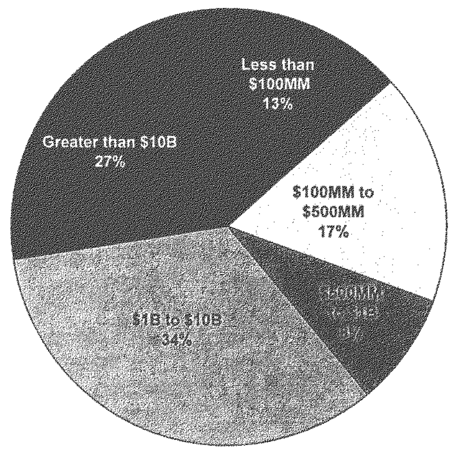


*Based on 2003 Dollars; $100MM in 2003 = $63.6MM in 1984.

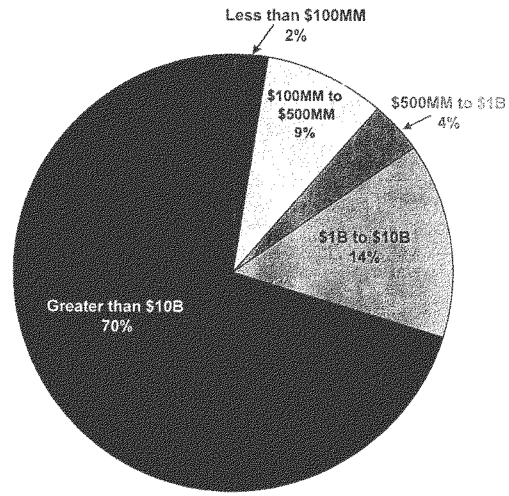
Chart 3

Change in Shares of Industry Assets
FDIC-Insured Commercial Banks and Savings Institutions

December 31,1984



December 31,2003

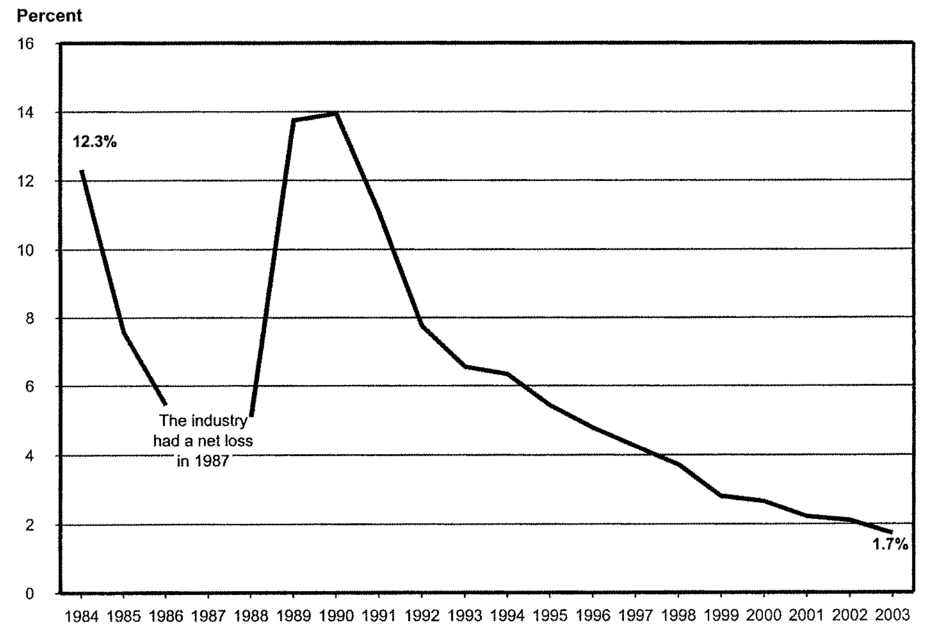


Asset sizes are not adjusted for inflation.

Chart 4

COMMUNITY BANKS' SHARE OF INDUSTRY EARNINGS IS DECLINING

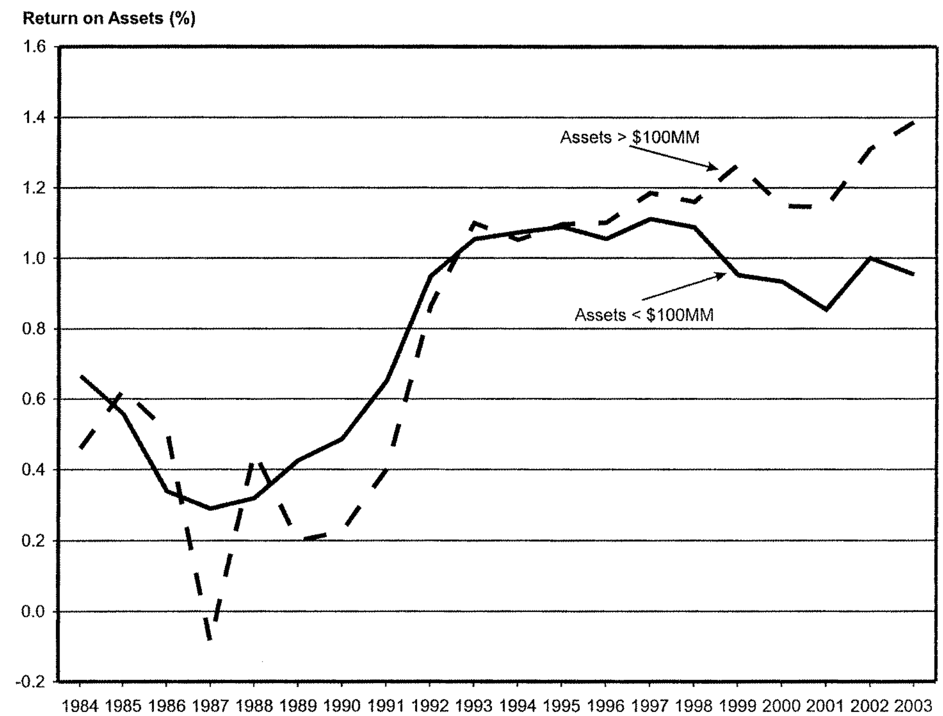
Net Income of Institutions With Assets < $100 Million* as a Percent of Total Industry Net Income



*Based on 2003 Dollars; $100MM in 2003 = $63.6MM in 1984.

Chart 5

LARGE INSTITUTIONS HAVE BECOME MORE PROFITABLE THAN COMMUNITY BANKS
All FDIC-Insured Commercial Banks and Savings Institutions, 1984 - 2003

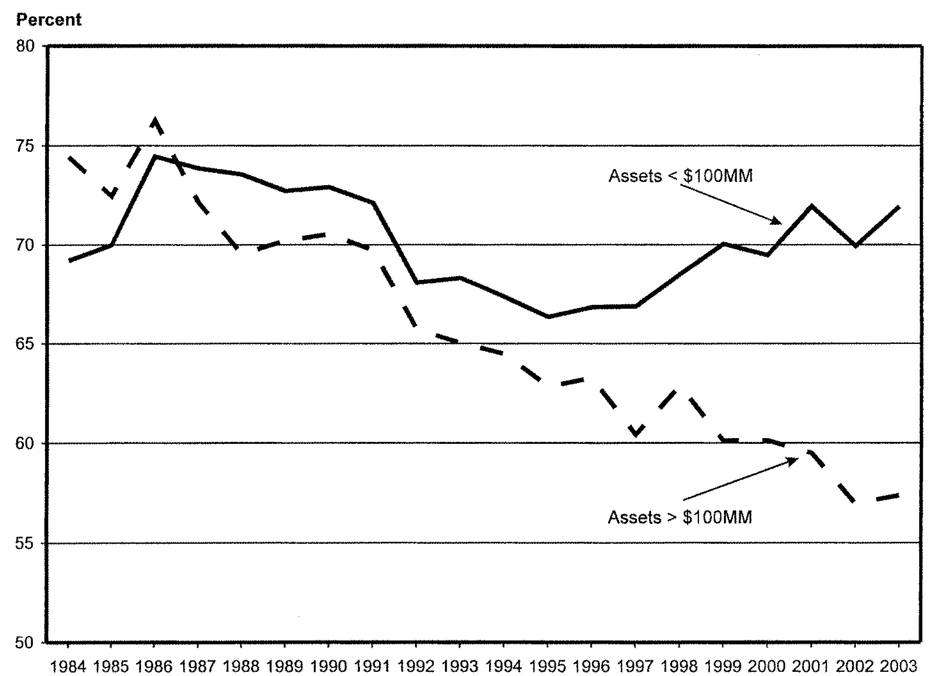


Asset size is based on 2003 Dollars; $100MM in 2003 = $63.6MM in 1984.

Chart 6

OVERHEAD COSTS ABSORB A GROWING SHARE OF COMMUNITY BANKS' REVENUES

Noninterest Expense as a Percent of Net Operating Revenue*



* Net operating revenue = net interest income + total noninterest income.
Asset size is based on 2003 Dollars; $100MM in 2003 = $63.6MM in 1984.

Testimony of

Bradley E. Rock

On Behalf of the

AMERICAN **BANKERS** ASSOCIATION

Before the

Subcommittee on Financial Institutions and Consumer Credit

Of the

Committee on Financial Services

United States House of Representatives

AMERICAN BANKERS ASSOCIATION ®

Testimony of Bradley E. Rock
On Behalf of the American Bankers Association
Before the
Subcommittee on Financial Institutions and Consumer Credit
Of the
Committee on Financial Services
United States House of Representatives

May 12, 2004

Mr. Chairman and members of the Subcommittee, my name is Bradley Rock. I am Chairman, President and CEO of Bank of Smithtown, a 95-year old, $625 million community bank located in Smithtown, New York. I am also the Vice Chairman of the Government Relations Council and a member of the Community Bankers Council of the American Bankers Association (ABA). The ABA brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership – which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks – makes ABA the largest banking trade association in the country.

I want to express our appreciation to you, Mr. Chairman, for your leadership in reducing unnecessary regulatory costs and for providing this forum to thoroughly discuss these issues. I would also like to acknowledge Congressman Bereuter, who throughout his many years in Congress has been instrumental in developing and passing legislation to reduce the regulatory burden.

I am glad to be here today to present the views of the ABA on the need to reduce the burden of red tape and paperwork. This is an important issue for ***all*** businesses, including banking. In my testimony, I would like to make three key points:

- The regulatory burden is not just a minor nuisance for banks – it has a significant impact on bank customers and local economies.

- The regulatory burden is significant for banks of all sizes, but pound for pound, small banks carry the heaviest regulatory load. The community bank, which has been the

cornerstone of economic growth in this country, is in great danger of being regulated right out of business.

- The review of regulatory costs by the federal bank regulators is very positive; results are what counts, however, and many bankers are skeptical that significant relief from the regulators is possible. It will take Congressional action to make a difference.

I will touch on each of these in the remainder of my statement.

I. The Regulatory Burden Has a Significant Impact on Bank Customers and Local Economies

Reviewing regulations and their impact on our businesses and communities should be an ongoing process, as the marketplace continues to change rapidly. Outdated laws and regulations only squander scarce resources of banks that could otherwise be used to provide financial services demanded by our customers. New laws, however well intentioned, have added yet more layers of responsibilities on businesses like ours. While no single regulation by itself is overwhelming to most businesses, the cumulative weight of all the requirements is overwhelming. It is like playing football against a defensive line that weighs 70 pounds more per player. New laws add heft to the regulatory burden like additional pounds increase the weight of an already massive defensive line. There is simply no way to advance the ball against such a barrier.

The burden of regulation has a significant impact on bank customers and local economies. Compliance costs are a significant drain on bank resources, taking precious resources away from meeting the needs of our customers. And every new law, regulation or rule added means two things: more expensive bank credit and less of it. This is likely to hurt small businesses the most, as they cannot go directly to the capital markets, yet need low-cost financing. The result is slower economic growth.

Over the past 25 years, the compliance burden has grown so large and is so pervasive throughout all levels of bank management that it is extremely difficult to measure. Research done by

the ABA and the Federal Reserve[1] in the 1990s indicates that the total cost of compliance ***today*** for banks would range from $26 billion to $40 billion per year. And these costs do not include the cost related to major legislation enacted in the last five years, such as the Gramm-Leach-Bliley Act, the Sarbanes-Oxley Act, the USA Patriot Act, and the FACT Act. Nor do these costs include the cumbersome layering of additional rules, issued by the Securities and Exchange Commission (SEC), the Financial Accounting Standards Board (FASB), the Public Company Accounting Oversight Board (PCAOB), and the American Institute of Certified Public Accountants (AICPA), which are often focused on financial instruments and financial institutions. Nor do these costs include changes in existing regulations either (such as the recently effective changes for HMDA reporting), which occur with such regularity that it is the modern equivalent of Chinese water torture.

Compliance costs are expected to grow at an even faster pace in the coming years. As the table below illustrates, bank compliance officers are bracing for large increases in spending for document development and generation, consultants, outside attorneys, software and offsite record storage.

Projections for 2003 compliance spending over 2002 spending
(Figures in Percentages)

	UP	DOWN	EVEN
Consultants	29.3	13.0	57.7
Outside attorneys	22.2	12.2	65.6
Mystery shoppers	6.9	13.8	79.3
Software	26.4	9.3	64.3
Offsite record storage	22.0	4.9	73.2
Document development & generation	34.5	3.6	61.9

Source: *ABA Banking Journal*, June 2003

[1] "Survey of Regulatory Burden", American Bankers Association, June 1992; Elliehausen, "The Cost of Banking Regulation: A Review of the Evidence," Staff Study, Board of Governors of the Federal Reserve System, April 1998.

Certainly, some of the regulatory cost is appropriate for safety and soundness reasons. But consider the direct impact on bank lending and economic growth if this burden could be reduced by 20 percent and redirected to bank capital; it would support additional bank lending of $52 billion to $78 billion. This would clearly have a big impact on our economies. In fact, it represents nearly 10 percent of all consumer loans or 15 percent of all small business loans.

II. Community Banks Are In Danger of Being Regulated Right Out of Business

Regulatory costs are significant for banks of all sizes, but pound for pound, small banks carry the heaviest regulatory load. In 1996, Congress found that "small businesses bear a disproportionate share of regulatory costs and burdens."[2] For the typical small bank, about one out of every four dollars of operating expense goes to pay the costs of government regulation. For large banks as a group, total compliance costs run into the billions of dollars annually.

The cumulative effect of new rules and regulations will ultimately force many community banks to look for merger partners to help spread the costs; some will go out of business altogether. At a recent meeting of ABA's Community Bankers Council, we had a long discussion on the future of banking. Consistently, every banker mentioned regulatory burden as the first or second critical factor threatening the viability of his or her community bank over the next five years. In fact, many bankers and bank consultants believe that half of the banks in the U.S. will disappear in the next five years because of the regulatory burden and that only banks greater than $500 million in assets will have the capacity to meet their regulatory obligations. These are quite shocking comments as there are 8,000 banks with less than $500 million in assets and only 1,100 above this level. As my bank is just above that asset size, I can tell you, Mr. Chairman, the pressures to comply with all the regulations and still meet the demands of our customers are enormous. We feel that we must grow the bank rapidly to generate more revenues simply to pay for the ever-increasing regulatory cost. The sad part is that too much time and effort is now devoted to compliance and not to serving our customers.

Bankers at all levels, from bank directors and CEOs to compliance managers and tellers, spend endless hours on compliance paperwork. In fact, much of the burden of regulatory paperwork

[2] Small Business Regulatory Enforcement Fairness Act of 1996

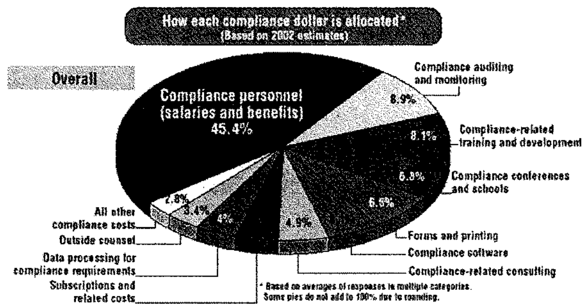
– for example, filling out hundreds of forms, providing reams of disclosure statements to loan customers and documenting virtually every community lending activity – falls heavily on tellers and loan officers. For example, HMDA alone requires the bank to complete 25 specific items on the Loan Application Register for every routine mortgage refinancing. Considering that more than 10 million mortgages were refinanced over the last three years and it is obvious that this is a huge reporting burden.

Considering the very high turnover for tellers and other business-line staff and the complexity of the regulations (particularly for mortgage lending), the training costs required to assure compliance with the many regulations is large and growing. In fact, compliance-related training and development and compliance conferences and schools, taken together, make up the second-largest portion of total compliance spending, after salaries and benefits.[3]

Compliance issues are discussed at virtually every meeting of the Board of Directors. I personally spend about one and a half days per week just on compliance issues. Some CEOs tell me that they are now spending nearly half of their time on regulatory issues. This means that for banking alone, CEOs spend over 5.5 million hours per year on compliance – time that could have been better spent on ways to expanding their businesses and to meet the changing needs of their customers.

Thus, compliance puts a big strain on manpower, especially at small banks. Large banks typically have many full-time employees devoted just to compliance. Many community banks cannot afford to have full-time staff for compliance. At Bank of Smithtown, every person in every department has major compliance responsibilities. Because of the complexities involved, my bank pays tens of thousands of dollars each year to an outside firm to help us with the big compliance issues. On top of this, one person on my staff has a full-time job just to coordinate all the activities throughout the bank related to regulatory compliance. Of course, labor costs are a small part of the entire cost required to meet all the compliance obligations that we have. In addition, banks spend billions annually on compliance training, outside compliance support (including accounting firms, consultants and attorneys), compliance related hardware and software, printing, postage, and telephone connections.

[3] *Compliance Watch, 2003. Nationwide Bank Compliance Officer Survey.* ABA Banking Journal, June 2003. Sponsored by the ABA Banking Journal, ABA Compliance Executive Committee and Bankers Systems, Inc.



Source: *Compliance Watch, 2003. Nationwide Bank Compliance Officer Survey.* ABA Banking Journal, June 2003.

I was shocked to learn from a banker this weekend that his bank – with only 20 employees – has had to add a full time person to complete reports related to the Bank Secrecy Act. Not only is this a huge expenditure of time and money, he and other bankers wonder if these reports are even being read. The cost vs. benefit analysis fails to make the case for many of the rules and regulations banks must follow, and the reports that we generate.

This banker is not alone. In fact, there are more than ***3,350 banks and thrifts with fewer than 25 employees; more than 1,000 banks and thrifts have fewer than 10 employees.*** These banks simply do not have the human resources to run the bank *and* to read, understand and implement the thousands of pages of new and revised regulations, policy statements, directives, and reporting modifications they receive every year. In fact, according to the Small Business Administration's Office of Advocacy, the total cost of regulation is 60 percent higher per employee for firms with fewer than 20 employees compared to firms with more than 500 employees due to the fixed costs associated with regulations.[4]

To illustrate the magnitude of this burden on small banks, consider this: Each year the ABA publishes a book called the "Reference Guide to Regulatory Compliance." This ***600-page reference*** guide attempts to ***summarize and outline*** the requirements embodied in thousands and thousands

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[4] Crain and Hopkins, "Impact of Regulatory Costs for Small Firms," Small Business Administration, Office of Advocacy, 2001

of pages of regulations promulgated from more than 50 statutory requirements. It covers 26 key requirements for consumer protection, ten for safety and soundness, eight on information reporting, seven on bank operations, and four on "social responsibilities" (such as CRA). The upcoming edition will no doubt have even more pages outlining the new responsibilities under the USA Patriot Act, the expanded HMDA reporting requirements, HIPAA requirements, additions under the Sarbanes-Oxley Act and the inevitable changes in regulations that occur every year.

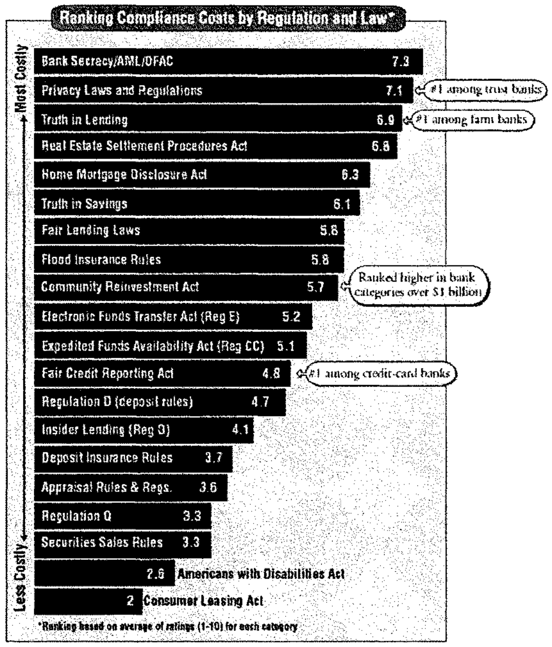
Moreover, this reference guide covers compliance obligation, but bankers face other call report and disclosure requirements by the banking regulators, and other new requirements from the SEC, FASB, PCAOB and AICPA.

In 2003, several Texas banks quantified the burden they face every day due to regulatory issues. One of those institutions, Austin Bank, a $600 million bank based in Jacksonville, Texas, calculated that its employees spend almost 31,500 hours annually on compliance issues. Almost 27,000, or over 85 percent of these hours are spent on Bank Secrecy Act or USA Patriot Act responsibilities at the bank. In excess of 14,000 of these hours alone are spent on currency transaction reporting.

Another institution, Southside Bank, Tyler, Texas, with $1.5 billion in assets, found that its employees spend over 13,000 hours annually on HUD, HMDA, CRA, and Truth in Lending Act compliance. The bank has found that while some regulations have real merit and do help the consumer, most consumers largely ignore the flood of disclosures they are presented with as part of a banking transaction. In addition, in the age of fast computers and quick decisions, the bank finds a real contradiction between meeting the technical requirements of regulatory disclosures and what their customers really are concerned about or interested in knowing, which is getting an account opened or a loan approved.

The experiences of these two banks are illustrative of a theme repeated consistently in the outreach meetings hosted by the regulatory agencies regarding the Congressionally-mandated review of existing regulations. It is clear from the comments of bankers at these meetings that the overwhelming burden is in statutes and regulations classified by the agencies as Consumer Protection and Anti-terrorism/Anti-money laundering. This corresponds with the most recent increases in

regulatory burden, including massive new HMDA reporting requirements, annual privacy notices, and extensive new USA Patriot Act requirements, including customer identification programs, and mandated responses to urgent law enforcement information requests. In fact, it appears that the great bulk of comments from bankers to the regulators about how to reduce the regulatory burden will fall into the two categories of consumer protection and anti-terrorism/anti-money laundering. The Chart below provides a ranking of the regulations based on their relative compliance cost.



Source: Compliance Watch, 2003, Nationwide Bank Compliance Officer Survey. ABA Banking Journal, June 2003.

Banks that are regulated by more than one bank regulatory agency have a particular challenge, in that opinions about what is correct or adequate with regard to certain regulatory requirements differ between agencies. Such banks currently lack one definitive answer about what is required and necessary to comply with any specific aspect of a regulation. Another challenge facing institutions is

the fact that compliance regulations can come from a variety of sources, including HUD and FTC for instance, that are not familiar with the banking industry and how it functions, and are not sensitive to the cumulative costs and burdens of compliance.

Sensitivity to the overall regulatory burden further needs to consider what new changes are being required of the industry from other standard setters, such as the SEC, FASB, PCAOB, and AICPA. The system lacks monitoring of the overall increasing regulatory and reporting burden on financial institutions. Just over the last few years, numerous accounting changes have been issued and have cost the industry an enormous amount of valuable staff time and money to implement. A few of the most recognizable rules include: fair value disclosures, accounting for derivatives, accounting for guarantees, accounting for loan loss reserves, accounting for special purpose entities, and accounting for purchased loans. These rules are being issued at a very rapid speed with an extraordinarily short amount of time given to implement them; this presents a significant challenge to all banking institutions. Moreover, we are concerned that a significant amount of time, effort and expense has been directed to rules that have not been demanded by investors and will not be used or even understood by them.

This year banks are also experiencing large increases in annual auditing fees as a result of the Sarbanes-Oxley Act and new rules developed by the PCAOB. Like many other community banks, my bank's accounting fees will double this year, and I see very little resulting additional benefit for our investors or our customers. Many publicly traded community banks are exploring whether to de-register under the Securities Exchange Act of 1934 because the huge regulatory expenses and the doubling – and even tripling – of accounting and legal costs that result directly from Section 404, Management Assessment Of Internal Controls, and other provisions of the Sarbanes-Oxley Act.

Another rule maker that I am compelled to mention is the International Accounting Standards Board (IASB). Although I am a community banker, and currently do not have to follow rules issued by the IASB, there is a rapid movement in the U.S. to converge accounting and reporting required by the FASB with those of the IASB. As the convergence continues, more and more demands will be placed on the industry that will require systems changes, process changes, and an increase in reporting requirements – and at what cost?

ABA believes there is a serious need to look periodically at the total picture of all new rules and requirements placed on the industry, prioritize those requirements, and assess what is immediate and what can be implemented over time.

The bottom line is that too much time and too many resources are consumed by compliance paperwork, leaving too little time and resources for providing actual banking services. I'm sure I speak for all bankers when I say that I would much rather be spending my time talking with our customers about their financial needs and how my bank will fulfill them than poring over piles of government regulations. The losers in this scenario are bank customers and the communities that banks serve.

III. Federal Banking Agency Review of Regulations Must Show Results; Congressional Support for Reduction is Critical

Congressional initiatives to roll back unnecessary regulation have created an environment within the bank regulatory community that has encouraged review, streamlining and even elimination of some unnecessary regulations. In fact, the agencies have made considerable progress in the last five years in improving some of their regulations. Nonetheless, not all of the agencies' regulations have been so revised, although we certainly recognize that, in many cases, the agencies are constrained by the language of statutes in reducing the burdens in a meaningful fashion.

We are hopeful that the current review of bank regulations, required under the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA), will provide meaningful relief. We applaud the openness of the banking regulators to the concerns of the industry as they conduct this review. Attachment 1 provides some of the key concerns communicated to the regulators in this process from ABA.

Doubt exists as to whether this effort will be – or even can be – successful in achieving a meaningful reduction in the burden. Most bankers have seen previous efforts at regulatory relief come and go without noticeable effect, while the overall level of regulatory burden has kept rising. Results are what matters.

There is a dilemma here: at the same time that the regulatory agencies are undertaking a review of all regulations with an eye toward reducing the overall compliance burden, they must promulgate new rules for the new laws that Congress has enacted. Simply put, any reduction in existing compliance obligations is likely to be obliterated by compliance requirements of new regulations implementing new laws. The hours that Austin Bank has devoted to compliance with the Bank Secrecy and USA Patriot Act shows how overwhelming new obligations can be.

We expect similar compliance energy to be expended when the numerous FACT Act provisions become effective. While ABA strongly supported that Act and commends Congress for its passage, some provisions of that act will impose additional new burdens. We strongly urge Congress to emphasize to the various agencies responsible for implementing the FACT Act regulations that those agencies be sensitive to compliance burdens when promulgating the regulations.

It should be noted that even when Congress has acted to reduce a burden, the agencies have at times not followed through. For example, in 1996, Congress amended RESPA so as to reduce the amount of information that must be provided to mortgage customers relating to a lender's sale, transfer or retention of mortgage loan servicing. This change eliminated the requirement that lenders provide historical data on the likelihood of this transfer and that customers acknowledge receipt of this information in writing. ***HUD has never implemented this statutory change to RESPA.*** Thus, since 1996 HUD's regulation continues to require language in the disclosure form, which Congress struck from the statute. This creates an unnecessary burden on banks.

Bankers continue to be concerned about "the uneven playing field" in compliance between depository institutions and other financial institutions. While bankers spend increasing amounts of time and money dealing with regulatory red tape, non-bank competitors, including money market funds and mutual funds, are selling savings and investment products to bank customers. The same is true of the local credit union and the Farm Credit System, both of which are free from much of the red tape and expenses imposed on banks. Even when the regulatory requirement is the same on paper, such as the case with the Truth in Lending requirements, non-bank competitors are not subject to the frequent, in-depth, on-site examination that banks are subject to. The result is slower growth for banks, leaving fewer community resources available for meeting local credit needs.

Bankers know that their loans will be examined for consumer compliance at least once every two years. They also know that nonbank lenders will not have their loans examined, probably ever, because the Federal Trade Commission and the state agencies that have jurisdiction over them do not have the examination and supervision infrastructure to do so. One solution is to fund, by assessment of the nonbank lenders, if necessary, a real supervisory examination program to stop some of the consumer abuse and predatory lending that we hear about constantly. Congress should ensure that the FTC has the resources to actually enforce against nonbank lenders the consumer protection laws currently in effect.

Importantly, the EGRPRA mandate encompasses more than just regulatory action: it calls for the agencies to advise the Congress on unnecessary burdens imposed by statute, which the agencies cannot change but the Congress can. As noted, in many cases, meaningful compliance burden reduction cannot be achieved absent statutory changes. Mr. Chairman, we hope this Subcommittee will seriously consider the recommendations made under this effort.

Conclusion

In conclusion, the cost of unnecessary paperwork and red tape is a serious long-term problem that will continue to erode the ability of banks to serve our customers and support the economic growth of our communities. We thank you for continuing to look for ways to reduce the regulatory burden on banks and thrifts, and to restore balance to the regulatory process. Mr. Chairman, the ABA is committed to working with you and the members of this subcommittee to achieve this goal.

Attachment 1

Some Specific Regulatory Concerns

ABA has raised several broad concerns with the bank regulators in comment letters on the EGRPRA review. First, the agencies need to consider the overall bank regulatory burden in making any new regulatory proposals, whether they are changes to existing regulations or implementation of new ones. Consider, for example, the major changes to the Home Mortgage Disclosure Act data collection and reporting requirements of Regulation C adopted by the Fed in December of 2001. Originally, the Fed would have required that the new data be collected in 2003, but the number of changes and the complexity involved were so great that the Fed subsequently amended the rule to require most data to be collected beginning in 2004.

The changes include a new census tract reporting system that uses five rather than four identifiers; a complex new reporting of whether applicants are of Hispanic ethnicity and of reporting from which races from a multiple racial designation system is the applicant; whether the loan is for a manufactured home; whether the loan is a HOEPA loan; whether the loan is secured by a first lien, junior lien or no lien; the rate gap on loans secured by a first mortgage that are more than three percent higher than similar term Treasuries, if a first lien, or five percent higher, if a junior lien; a change in the definition of home improvement loans; a major change in the definition of refinance that captures for the first time significant numbers of commercial loan refinancings; newly requiring government monitoring information on ethnicity, race, and gender on telephone applications; a requirement making preapprovals of loans subject to HMDA reporting; and a new identifier for a purchaser of the loan. ***Almost all home mortgage applications had to be revised and reprinted, every telephone and electronic application system had to be revised, every automated computer system for HMDA data collection had to be extensively reprogrammed, and virtually every mortgage lending officer had to be retrained in order to implement these changes.*** The industry is still staggering under the burden of adjusting to the burden of these changes.

Agencies should also always take into account regulatory burden arising from those other regulators and rulemakers. There are examples where this has not occurred. For example, the Department of Housing and Urban Affairs recently proposed a significant revision of Regulation X

which implements the Real Estate Settlement Procedures Act that was inconsistent with the closely related existing Truth in Lending Act regulations, promulgated by the Federal Reserve Board. If adopted, it would have created much new burden and great confusion. Thus, we believe that it is not enough just to review banking regulations. The agencies and the industry need to review the entire burden of regulation on banking.

Second, bankers are concerned that some regulatory proposals from the agencies suggest that the staff members writing the proposals are not as familiar with banking practice and the current level of regulatory burden as they might need to be. For example, the existing HUD requirement that hazard insurance and property taxes for junior liens and home equity loans be disclosed on the Good Faith Estimate and HUD-1 creates regulatory burden for banks and confusion for their customers. Frequently a bank does not have access to this information and must ask the customer for such information in order to provide disclosures back to the customer. At the same time, the customer is confused because the hazard insurance and property taxes disclosed are already paid as escrowed in servicing the first lien. Eliminating this redundancy will benefit lenders and their customers.

ABA believes that familiarity is crucial to reducing the regulatory burden, to minimize ***changes*** to existing regulations as much as possible and to avoid new regulations. ABA is concerned that the cost and burden of regulatory changes and new requirements are often underestimated. It is assumed that a new disclosure or revision to an existing disclosure means simply purchasing the new forms and software. But it usually involves much more. Banks must always look for changes to existing regulations and new requirements, review them, make necessary modifications, order new forms and programs, revise websites and advertisements, educate staff, prepare staff for customer inquiries, and implement auditing measures. As one banker put it, "Just hold still!"

The agencies also could be more sensitive to regulatory burdens and costs when proposing changes to regulations. A good example is the Federal Reserve Board's (Fed) proposal in late 2003 to alter the meaning of "clear and conspicuous" for virtually all required consumer protection disclosures. While well intentioned, the Fed's staff seemed unaware that all forms, all documents, all software programs, all advertisements, websites, education materials, etc., would have to be reviewed, revised, and redistributed and that staff would have to be reeducated. The Fed's staff also seemed to equally underestimate the costs associated with potential litigation, both the actual costs as well as the

costs associated with litigation avoidance, all well-documented costs. And yet, there is little if any evidence that the existing disclosures are inadequate so as to justify enormous new compliance costs.

The March 2003 amendments to Regulation B and its Commentary involving joint applications provides another example of how regulatory changes, which appear to be minor, can create confusion and compliance burdens. The Fed modified the regulation to clarify the need for creditors to document that co-applicants have applied for a loan. The Fed also added language to the model forms so that applicants could specifically indicate whether they were applying jointly or individually.

While the Fed stated that written applications are not necessary (except where otherwise required) and that model forms are optional, some institutions and examiners incorrectly concluded that the changes required written applications and that the language added to the model forms is mandatory. Some agency examiners also asserted that certain common secondary mortgage forms no longer complied. On this basis, some creditors altered their forms.

The bottom line is that even though an Agency may issue an advisory that revisions or procedures are optional, compliance officers see a significant risk in not adopting what seems to be sanctioned forms or language. Retaining current forms along with new language would reinforce the concept of flexibility and choice.

Third, we believe that the Paperwork Reduction Act has outlived its usefulness as a mechanism to achieve meaningful reductions in regulatory burden. Amendments to the law in 1995 removed from judicial review approvals of paperwork collections by the Director of OMB. This essentially eliminated any effective challenge to new paperwork burden by banks and their trade associations. Since then, the filings by the agencies and the review of them by the OMB have become just routine. Moreover, responses to OMB requests for comment on the paperwork burden have apparently dropped to almost nothing, since virtually every request for maintenance or additional paperwork is approved under the current process. Thus, commenting would be a waste of precious time. Simply put, the Paperwork Reduction Act is not effective in reducing or preventing additional paperwork and may just be serving to increase agency paperwork.

TESTIMONY OF

JOSEPH A. SMITH, JR.

NORTH CAROLINA COMMISSIONER OF BANKS

On behalf of the

CONFERENCE OF STATE BANK SUPERVISORS

before the

FINANCIAL SERVICES SUBCOMMITTEE ON FINANCIAL INSTITUTIONS

UNITED STATES HOUSE OF REPRESENTATIVES

May 12, 2004

Good morning, Chairman Bachus, Representative Sanders and members of the Subcommittee. I am Joseph A. Smith, Jr., North Carolina Commissioner of Banks and Legislative Committee Chairman for the Conference of State Bank Supervisors (CSBS). Thank you for inviting CSBS to be here today to discuss strategies for reducing unnecessary regulatory burden on our nation's community banks and your interest in preserving a system that supports our country's unique system of community banking.

CSBS is the professional association of state officials who charter, regulate and supervise the nation's approximately 6,400 state-chartered commercial and savings banks, and nearly 400 state-licensed foreign banking offices nationwide.

CSBS gives state bank supervisors a national forum to coordinate, communicate, advocate and educate on behalf of the state banking system. We especially appreciate this opportunity to discuss our views in our capacity as the chartering authority and primary regulator of the vast majority of our nation's community banks.

Chairman Bachus, we applaud your longstanding commitment to ensuring that regulation serves the public interest without imposing unnecessary or duplicative compliance burdens on financial institutions. To support our diversified system of community banking, CSBS and the state bank commissioners are now working in full partnership with the Federal Financial Institutions Examination Council to implement the Economic Growth and Regulatory Paperwork Reduction Act of 1996. This process has highlighted

several insights that we believe should inform this committee's work. This testimony will present these insights and offer specific examples and recommendations for Congressional action.

1. A bank's most important tool against regulatory burden is its ability to make meaningful choices about its regulatory structure.

In recent testimony before the Senate Banking Committee, Federal Reserve Chairman Greenspan referred to the American dual banking system and its support of community banks as a "jewel" of our economy. State bank supervisors see the value of this jewel every day. The preservation of a state bank chartering and regulatory system sets the United States' financial system apart from every other developed nation, and is a primary contributor to our nation's diverse, vibrant, resilient and responsive economy.

Community banking is the cornerstone of this system. Let me be clear. Diversity in our financial system is not inevitable. Community banking is not inevitable. They are the product of a consciously developed state-federal system. At the state level, we know that a responsive and innovative state banking system that encourages community banking is essential to creating diverse local economic opportunities. This is why we are so passionate in our defense of a federal structure that allows for state chartering and supports community banking. American banks have traditionally been able to choose a bank charter that best suits their business plans. The state charter has been and continues to be the

charter of choice for community-based institutions, because the supervisory environment – locally-oriented, hands-on, and flexible – matches the way these banks do business. Our goal is a safe and sound financial system that meets the needs of all our communities. This goal requires that we find a balance between encouraging economic opportunity and protecting our citizens.

A bank's ability to choose its charter encourages regulators to operate more efficiently, more effectively, and in a more measured fashion. A monolithic regulatory regime would have no incentive to efficiency. It is easy to imagine how fast its authority and its costs might grow if left unchecked. Our founding fathers knew that federalism was the best check on this government overgrowth, and therefore left control of financial regulation in the hands of the states. The emergence of a nationwide financial market made it necessary to create a federal regulatory structure, but the state system remains as a structural curb on excessive federal regulatory burden and a means of promoting a wide diversity of financial institutions.

2. Our current regulatory structure does recognize differences between financial institutions, but too often imposes "one size fits all" requirements that are unduly burdensome on smaller or community-based institutions.

Regulatory burden always falls hardest on smaller institutions. Some of this may be unavoidable. As Vice Chairman Reich has reported in his testimony, the FDIC's most recent figures show a growing earnings gap between the nation's

largest and smallest banks. To the extent that economies of scale exist in the banking industry, they exist because any bank has a set of fixed costs it cannot evade. Compliance forms a large percentage of these fixed costs.

As I mentioned earlier, state-chartered banks tend to be community-based institutions, and therefore tend to be smaller than their federally-chartered counterparts. State-chartered banks make up slightly more than 74% of all commercial banks nationwide, but hold less than 44% of U.S. banking assets. If you subtract the assets of the largest state banks (as of year-end 2003, 47 of the nation's largest 100 commercial banks hold state charters) we see that community banks represent a shrinking percentage of the assets of our nation's banking system.

The Conference of State Bank Supervisors asked its Bankers Advisory Board, as part of our EGRPRA comment process, about the impact of regulatory burden on their institutions. Their responses illustrated how disproportionately heavily the regulatory burden falls on smaller institutions. We request that our comment letter dated September 15, 2003, on regulatory burden relief, with very specific suggestions on alleviating regulatory burden, be submitted for the record.

One member of our Bankers Advisory Board, the CEO of a $150 million bank, reported that his bank employs the equivalent of four or five full-time employees who focus exclusively on compliance. The bank thus dedicates an excessively high percentage of its employees to compliance instead of to customer service or lending. This commitment places the bank at a competitive

disadvantage not only to larger banks but also to non-bank financial services providers that are not subject to many bank regulations.

Chairman Bachus, the Congress and the federal regulatory agencies have already made many adjustments to regulatory requirements that exempt or reduce burden on institutions that are smaller or well-managed. The FDIC's MERIT examination program, for example, reduces onsite examination requirements for well-managed institutions below a certain size. Raising the asset size of institutions that qualify for the MERIT program has significantly reduced the supervisory burden for thousands of banks.

We suggest, however, that Congress and the regulatory agencies seek creative ways to tailor regulatory requirements for institutions that focus not only on size, but on a wider range of factors that might include geographic location, structure, management performance and lines of business. As the largest banks are pushing for a purely national set of rules for their evolving multistate and increasingly retail operations, keep in mind that this regulatory scheme will also impose new requirements on state-chartered banks operating in the majority of states that do not already have similar rules in place. If we are to preserve a system of community banking, Congress and bank regulators should rethink how these highly complex laws and reams of compliance regulations will apply, or even if they should apply, to smaller community banks.

It is difficult, for instance, for many community banks to meet the investment test under the Community Reinvestment Act. Restrictions on insider

dealings make it difficult, in some cases impossible, for banks in rural areas to recruit qualified directors. Home Mortgage Disclosure Act (HMDA) reporting requirements are exceptionally burdensome on community-based institutions, and have the unintended consequence of encouraging bank holding companies to maintain multiple bank charters to avoid some of the asset threshold requirements.

Every new national standard is generally a new regulatory burden for the majority of banks. Regulatory relief for the handful of market-dominating banks that operate in multiple states generally means new and unanticipated regulatory burdens for the thousands of community banks that operate in a single state or a single community.

A new approach to lawmaking and regulation is imperative if we are to accommodate the larger institutions' understandable and growing demand for a more uniform national market while preserving the community bank system that is largely responsible for our uniquely American business culture of entrepreneurship and broad access to credit.

Congress has established different and more minimal standards for credit unions than commercial banks. Congress might consider a similar perspective for community banks.

It is fairly universally accepted that the state banking system is a foundation of our community banking system. Equally important, the state system has provided meaningful choice for institutions of all sizes, which has injected major innovations into the banking system. Congress, recognizing this dynamic, has

consistently tried to ensure that federal law and policy preserve the state charter as an option for all banks. The Riegle-Neal interstate banking and branching act of 1994, free standing legislation to amend Riegle-Neal in 1997 and the Gramm-Leach-Bliley financial modernization act of 1999 were all conscious efforts to preserve the state charter and provide it as an option for multistate and complex financial institutions.

We are now hearing from some of the largest state-chartered banks that the OCC's unilateral action to preempt state laws and authority is putting them at a significant competitive disadvantage relative to national banks. They are telling us that if Congress does not address this imbalance in the system -- which was contradictory to congressional intent -- the state charter may no longer be an option. I remind you, 47 of the 100 largest commercial banks are state-chartered. If this imbalance caused all 100 of the largest banks to become nationally chartered, the state system would supervise only 17% of U.S. commercial banking assets, and the damage to the dual banking system would be immeasurable. It is not clear that such a system would even be sustainable. Mr. Chairman, failing to act on this issue is its own decision, and would be a major policy shift away from the Congress's historic support of the dual banking system.

We look forward to working with the members of this committee and with our federal counterparts to find ways of targeting new policies and requirements to maximize their effectiveness and minimize their burden. State regulators, with

their tradition of tailoring supervision to a specific institution's need, can share their experiences and offer valuable insight.

3. Technology continues to be an invaluable tool of regulatory burden relief, but it is not a panacea.

Technology has helped reduce regulatory burden in countless ways. State banking departments, like their federal counterparts, now collect information from their financial institutions electronically as well as through onsite examinations. Most state banking departments now accept a wide range of forms online, and allow institutions to pay their supervisory fees online as well. Many state banking departments allow institutions online access to maintain their own structural information, such as addresses, branch locations, and key officer changes.

At least 25 state banking agencies allow banks to file data and/or applications electronically, through secure areas of the agencies' websites. Forty-seven states have adopted or are in the process of accepting an interagency federal application that allows would-be bankers to apply simultaneously for a state or national bank or thrift charter and for federal deposit insurance.

Shared technology allows the state and federal banking agencies to work together constantly to improve the examination process, while making the process less intrusive for financial institutions. Technology helps examiners target their examinations through better analysis, makes their time in financial institutions more effective, and expedites the creation of examination reports.

The fact that technology makes it so much easier to gather information, however, should not keep us from asking whether it is necessary to gather all of this information, or what we intend to do with this information once we have it. Information-gathering is not cost-free.

Our Bankers Advisory Board members have expressed particular concern about Bank Secrecy Act requirements, Currency Transaction Reports and Suspicious Activity Reports. These collection requirements have become far more extensive in the past three years, representing the new importance of financial information to our national security. Industry representatives, however, estimate that CTRs cost banks at least $25 per filing. Although they understood the importance of gathering this data, our Bankers Advisory Board members reported widespread frustration at the perception that law enforcement agencies do little, if anything, with this costly information. FinCEN's new Director, William Fox, has indicated that his agency plans to provide more information to bankers about how these reports are used to thwart crimes. We would still urge Congress, FinCEN and the federal banking regulators to simplify the reporting forms and look carefully at potential changes to threshold levels.

4. No amount of legislative reform can be effective unless regulators coordinate to reduce unnecessary duplication.

The regulatory structure that makes choice possible in our banking system also creates a complex network of overlapping, occasionally contradictory

regulations and policies. Coordination among regulatory agencies is the only way to eliminate unnecessary duplication while preserving diversity in our system.

The Conference of State Bank Supervisors brings state regulators together in a variety of forums to improve communication and coordination among states and with federal agencies. The enactment of interstate branching laws in the early 1990s, first at the state or regional level and then at the federal level, demanded that we develop a system for supervising state banks across state lines that minimized duplication but ensured that all a bank's customers received equal protection under the law.

CSBS, with the FDIC and the Federal Reserve System, formed the State-Federal Working Group to develop a seamless, coordinated supervisory system for state-chartered banks that operate across state lines. The Nationwide Cooperative Agreement, signed by all 54 state banking departments, and the Nationwide State/Federal Supervisory Agreement, signed by the states, the FDIC, and the Federal Reserve, create a structure for sharing information and authority, and designating single state and federal supervisory points of contact for state-chartered banks that operate across state lines.

These agreements have served as a model for cooperation and coordination among the states and the federal regulators, and led to a similar set of agreements for the supervision of state-regulated offices of foreign banking organizations. CSBS has also worked closely with the FDIC and Federal Reserve Board in updating interagency coordination protocols and ensuring that all field examiners

learn recommended practices. We will work constantly in these areas as banks continue to grow across state lines and conduct increasingly complex activities.

Banks are not the only financial institutions that stand to benefit from this increased cooperation and coordination. CSBS created a task force to improve coordination of multistate trust companies, and created a model form that states can use to process state-licensed trust companies' requests to operate across state lines. In the wake of financial modernization, CSBS also formed joint task forces with the North American Securities Administrators Association (NASAA) and the National Association of Insurance Commissioners (NAIC) to share information and coordinate supervision of banks' nonbanking activities.

Most recently, state bank supervisors have concerned themselves with the operation of mortgage lending businesses across state lines. CSBS has created task forces on predatory lending and, more broadly, on mortgage lending that are taking a comprehensive look at how our members supervise and regulate these businesses across state lines. Understanding that a single set of rules and remedies is not always appropriate for every lender or for every group of borrowers, we intend to review best practices and develop recommendations for ways to protect consumers while ensuring a wide range of credit choices for homebuyers and supporting the evolving nationwide markets for mortgage lending.

We are working with the American Association of Residential Mortgage Regulators (AARMR) to promote a uniform mortgage lending activity application for these entities that lend across state lines. CSBS is also exploring the

possibility of creating a national database to simplify the application and state approval process for mortgage lenders and brokers. This database could allow multistate institutions to submit a single application, while giving states better historical data about employment, compliance practices, and criminal activity of these licensees.

5. Although regulators constantly review regulations for their continued relevance and usefulness, many regulations and supervisory procedures still endure past the time that anyone remembers their original purpose.

Many regulations implement laws that were passed to address a specific issue; these regulations often stay on the books after the crisis that required new legislation has passed. Recognizing this, many state banking statutes include automatic sunset provisions. These sunset provisions require legislators and regulators to review their laws at regular intervals to determine whether they are still necessary or meaningful.

We could hardly do that with the entire federal banking code, but last year's experience in passing the new Fair Credit Reporting Act legislation showed how valuable this review process can be. We urge Congress to apply this approach to as wide a range of banking statutes as possible.

Challenges to Regulatory Burden Relief

The current trend toward greater, more sweeping federal preemption of state banking laws threatens all of the regulatory burden relief issues described above.

Federal preemption can be appropriate, even necessary, when genuinely required for consumer protection and competitive opportunity. The extension of the Fair Credit Reporting Act amendments, which Congress approved last year, met this high standard, and we congratulate Congress for passing this important legislation.

The Comptroller of the Currency's recent actions, however, do not meet these standards, and in fact contravene a large body of legislative and judicial precedents. The Comptroller has made forceful arguments to the effect that these regulations reduce regulatory burden, but we must ask: for whom, and at what cost?

We appreciate that the largest financial services providers want more coordinated regulation that helps them create a nationwide financial marketplace. We share these goals, but not at the expense of distorting our marketplace, denying our citizens the protection of state law, or eliminating the diversity that makes our financial system great. The Comptroller's regulations may reduce burden for our largest, federally-chartered institutions, but they do so at the cost of laying a disproportionate burden on state-chartered institutions and even on smaller national banks.

The OCC's new regulations usurp the powers of the Congress, stifle states' efforts to protect their citizens, and threaten not only the dual banking system but also public confidence in our financial services industry. They challenge the functional regulatory structure created by Gramm-Leach-Bliley and set the Office of the Comptroller of the Currency as the nation's dominant regulator of financial institutions. They also seem to encourage consolidation among our largest institutions, concentrating financial risk in a handful of gigantic institutions that may become – if they are not already – not only too big to fail, but also too big to supervise effectively.

As these institutions grow and become more unwieldy, it is easy to imagine their financial ups and downs driving federal financial services policy even more strongly than they already do. Members of this committee may remember, as I do, the reform legislation of the early 1990s, which corrected the system's worst abuses at the cost of creating unprecedented new levels of regulatory burden and the worst credit crunch in recent memory. Chairman Bachus, the first regulatory relief initiatives date back to this time, when you saw how disproportionately these measures affected our healthy community banks.

Conclusion

Mr. Chairman, members of the subcommittee, the regulatory environment for our nation's banks has improved significantly over the past ten years, in large part because of your vigilance.

As you consider additional ways to reduce burden on our financial institutions, we urge you to remember that the strength of our banking system is its diversity – the fact that we have enough financial institutions, of enough different sizes and specialties, to meet the needs of the world's most diverse economy and society. While some federal intervention may be necessary to reduce burden, relief measures should allow for further innovation and coordination at both the state and federal levels. Centralizing authority or financial power in one agency, or in a small group of narrowly-regulated institutions, would threaten the dynamic nature of our financial system.

State supervision and regulation are essential to our decentralized system of banking. State bank examiners are often the first to identify and address economic problems, including cases of consumer abuse. We are the first responders to almost any problem in the financial system, from downturns in local industry or real estate markets to the emergence of scams that prey on senior citizens and other consumers. We can and do respond to these problems much more quickly than the federal government, often bringing these issues to the attention of our federal counterparts and acting in concert with them.

The Comptroller has argued that the laws and rules states have enacted to protect their citizens are burdensome to national banks. In my home state of North Carolina, where we enforce an anti-predatory lending statute, my office has never received a consumer complaint about not receiving credit due to the regulatory burden on a lender. State supervisors are sensitive to regulatory burden, and

constantly look for ways to simplify and streamline compliance. Your own efforts in this area, Chairman Bachus, have greatly reduced unnecessary regulatory burden on financial institutions regardless of their charter. The industry's record earnings levels suggest that whatever regulatory burdens remain, they are not interfering with many banks' – particularly the very largest institutions' -- ability to do business profitably.

The continuing effort to streamline our regulatory process while preserving the safety and soundness of our nation's financial system is critical to our economic well-being, as well as to the health of our financial institutions. State bank supervisors continue to work with each other, with our legislators and with our federal counterparts to balance the public benefits of regulatory actions against their direct and indirect costs.

We commend you, Mr. Chairman, and the members of this subcommittee for your efforts in this area. We thank you for this opportunity to testify, and look forward to any questions that you and the members of the subcommittee might have.

Attachment

September 15, 2003

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
Attn: Comments/OES

Re: Economic Growth and Regulatory Paperwork Reduction Act of 1996 Request for Comment (Docket No. 2003-20)

Dear Mr. Feldman:

The Conference of State Bank Supervisors ("CSBS") [1] welcomes the opportunity to respond to the Federal Financial Institution Examination Council's ("FFIEC's") request for comment [2] ("request") on its review of the financial institution regulations to reduce burden imposed on insured depository institutions, as required by section 2222 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA). We believe it is important to support the goals of materially reducing regulatory burden currently imposed on the financial institution industry. In this regard, we applaud the FFIEC's efforts to reduce and simplify regulations that industry comments indicate are outdated, ineffective, or simply no longer meet the requirements initially enacted by Congress.

The FDIC's Vice Chairman John Reich and his Office have taken the leadership role in this regulatory endeavor. In this role, the Project Manager for the Vice Chairman and the EGRPRA comment and review process, Claude Rollin, has coordinated with CSBS to provide a personal request for comment to several state bank commissioners as well as our Bankers Advisory Board (BAB)[3]. In that request, Mr. Rollin made it clear that the Vice Chairman's Office is very interested in the industry's comments on reducing regulatory burden. Accordingly, CSBS held a conference call with its BAB to obtain the bulk of the comments contained in this letter. In the future, CSBS may share additional comments with the FFIEC from state bank commissioners, including those who serve

[1] CSBS is the professional organization of state officials responsible for chartering, regulating and supervising
the nation's 6,395 state-chartered commercial and savings banks and 419 state-licensed branches and agencies
of foreign banks.
[2] 68 Fed. Reg. 35589, (June 16, 2003).
[3] The CSBS Bankers Advisory Board is the organization's bank membership leadership group, which provides advice and support to the Board of Directors, and serves as a resource to CSBS members and staff throughout the year.

on the FFIEC "State Liaison Committee." We ask that the FFIEC consider all comments to reflect CSBS' view on this extremely important issue.

Background

EGRPRA, passed by Congress in 1996, requires the FFIEC and each appropriate Federal banking agency represented on the FFIEC to conduct a review of all regulations prescribed by the FFIEC or by any such appropriate Federal banking agency to identify outdated or otherwise unnecessary regulatory requirements imposed on insured depository institutions. This review must take place at least once every ten years. In conducting the review the FFIEC is required to categorize the regulations and at regular intervals, provide notice and solicit public comment on a particular category or categories of regulations, requesting commentators to identify areas of the regulations that are outdated, unnecessary, or unduly burdensome. The FFIEC will publish the categories for which they are seeking comments twice a year. For this first publication, comments are requested for the following three categories of regulations: Applications and Reporting, Powers and Activities, and International Operations. Accordingly, the FFIEC must complete this review, eliminate unnecessary regulations to the extent that such action is appropriate, and provide an update to Congress no later than 2006.

To encourage full participation in the EGRPRA review, the Vice Chairman's Office has conducted several banker outreach sessions in Orlando, Florida, St. Louis, Missouri, and Denver, Colorado. A state bank commissioner, a CSBS representative, and representatives from all of the other Federal regulatory agencies have participated in all of the outreach sessions.

Industry comments from these outreach sessions have continued to develop a consistent list of regulations that should be reviewed and altered to reduce regulatory burden. The issues most frequently identified by financial institutions as burdensome or outdated include the USA PATRIOT Act, Bank Secrecy Act, Regulation D and the limitations on withdrawals from money market deposit accounts, Home Mortgage Disclosure Act, Expedited Funds Availability Act, Community Reinvestment Act, Truth in Lending Act (with special emphasis on the right of rescission), Privacy notices, and limitations on extending credit to insiders.

CSBS' Bankers Advisory Board Comments
During our conference call with the CSBS Bankers Advisory Board, a member highlighted the importance of the EGRPRA regulatory burden reduction process. This BAB member is the president of a $150-million community bank that employs four to five full time equivalent employees that focus exclusively on compliance. He also noted that non-banking entities do not have such compliance requirements and remarked that

this places his small bank at a competitive disadvantage. CSBS looks forward to working with the Federal banking agencies to reduce regulatory burden where possible.

The BAB conference call coordinated through CSBS uncovered items similar to those identified by industry representatives at the EGRPRA outreach meetings. BAB members provided details that might be of assistance when the FFIEC reviews the amount of burden imposed by these regulations. A summary of their comments and suggestions follows:

Currency Transaction Reports (CTR) and Suspicious Activity Reports (SAR)

- Although it was noted that industry representatives have estimated the cost of each CTR to be $25, that price is likely higher for smaller banks.
- One member of the BAB computed the cost of filing CTRs for his bank, assuming the average $25 per CTR is accurate. His bank generates 240 CTRs a day (approximately 65,000 a year). An average cost of $25 per CTR equates to an annual cost of $1.6 million. Separately, the same bank files about 50 SARs per year.
- The members of the BAB expressed widespread frustration because it appears that law-enforcement authorities do nothing with CTRs and SARs. One member reported that the FBI has failed to follow up on a SAR submitted two years ago involving a $2.4-million check kiting scheme. Another member of the BAB stated that the FBI has yet to act on a $140,000 note forgery. Law enforcement officials have indicated to both bankers that homeland security matters hinder and prevent investigatio ns such as these. Our members question, if the CTRs are not going to be investigated, why the banks should shoulder such high costs to file them.
- CSBS noted to the BAB members that FinCEN is investigating electronic submissions of CTRs. The bankers, however, noted that their biggest cost involves the research and file-checking that are required to generate CTRs and SARs.
- Furthermore, one of the BAB members noted that banks are required to report on CTRs and SARs, at least in summary form, to their Boards of Directors -- another cost item.

USA PATRIOT Act and "Know Your Customer"

- Members of the BAB, especially those in smaller communities, felt the "Know Your Customer" requirements add little value in investigating terrorism.
- When asked about documenting (possibly photocopying) customer identification information to be kept with signature cards, the members felt it would merely be "just another gotcha item" on examiners' checklists. BAB members also expressed concern that maintaining pictures of custome rs could result in claims of racial bias or profiling.

Limitation of Withdrawals from Money Manager Deposit Accounts
• The members of the BAB felt this limitation is completely outdated. It is anticompetitive
to smaller banks that do not have sweep accounts or have to compete
with non-bank entities that do not have similar restrictions.

Home Mortgage Disclosure Act (HMDA)
• BAB members believe the small bank threshold for reporting under the Home Mortgage Disclosure Act is no longer realistic. The members suggested increasing the asset threshold to at least $500,000, but $1 or $2 million is more realistic.
• Bankers noted that some holding companies keep a number of charters to stay under the HMDA and CRA asset size.

Community Reinvestment Act (CRA)
• BAB members noted that smaller banks are hardest hit by CRA requirements. It's difficult, if not impossible, for many of the smaller banks to meet the investment criteria.
• One member credited the FDIC as setting a precedent by allowing CRA credit for participation in the Money Smart financial education program. The precedent should be extended to give CRA credit for other good works, such as sponsoring Little League teams and the like.

Expedited Funds Availability
• BAB members agreed that this regulations needs to reviewed. The requirement that funds from cashiers' checks be granted on a next-day basis is generating significant fraud losses due to new technologies that allow scanning and/or color-copies.

Real Estate Settlement Regulations
• BAB members suggest that huge improvements could be made to lessen the regulatory burden in documents required for real estate loan settlement. It was suggested that lessening the amount of disclosure required may assist consumers by allowing them to focus on fewer papers. We have enclosed examples of the settlement documents that one of the BAB members suggested could be eliminated.
• BAB members also suggested that the Truth in Lending Act's right of rescission should be eliminated. Bank customers have complained when they do not receive refinance monies immediately upon loan closing. No bank on the BAB has ever had a right of rescission excersized.

Limitations on Insider Dealings
• For smaller banks, these regulations have the effect of driving their potentially best customers to other institutions. Banks can give preferred loan rates to employees, but not to officers and directors.
• BAB members expressed an interest in having regulators separate insider abuses from

justified preferential treatment for insiders who merit it, as banks can do for employees.

Flood insurance

• FEMA flood maps are often years out of date.
• Generally, flood maps are not changed for 10-12 years, even though action has been taken to change the flood plane. Research, however, to change the 100 year flood plane is costly for banks to consider.
• In those cases where banks attempt to update the flood maps, there are paperwork delays. Examiners criticize banks for making a determination on the flood insurance question until some kind of official paperwork is in the loan file, even though "you know the house is on top of a hill and not going to be flooded," said one BAB member.

Conclusion

CSBS commends the FFIEC's and the FDIC's efforts to review all banking regulations in order to reduce regulatory burden. In conclusion, we would like to highlight that new proposed regulations on identity theft were released following the conference call with our BAB. Such regulations certainly may be necessary to protect consumers against malfeasants taking advantage of changing and updated technologies to commit fraud. As regulations continue to proliferate, however, it is critically important that regulators continually evaluate which regulations may no longer be necessary.

We also note that as the difference between banks, savings associations, credit unions, and investment/ brokerage firms continues to blur, it is important to ensure that financial institutions are not placed at a competitive disadvantage. CSBS further recommends regulators use sunset provisions in regulations. Such provisions would require regulations to be reviewed on a regular basis to ensure the need for the regulation still exists.

CSBS welcomes the opportunity to work with the FFIEC to assist in alleviating outdated an unduly burdensome regulations. Thank you for your consideration and we invite you to contact CSBS for any additional information or assistance.

Best personal regards,

Neil Milner

Neil Milner
President and CEO

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TESTIMONY

OF THE

NATIONAL COMMUNITY REINVESTMENT COALITION (NCRC)

COMMITTEE ON FINANCIAL SERVICES SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

ON

"CUTTING THROUGH THE RED TAPE: REGULATORY RELIEF FOR AMERICA'S COMMUNITY-BASED BANKS"

SUBMITTED BY

JOHN TAYLOR
PRESIDENT AND CEO

MAY 12, 2004

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Introduction

Good Morning Chairman Bachus, Ranking Member Sanders and distinguished Members of the Committee. My name is John Taylor and I am President and CEO of the National Community Reinvestment Coalition (NCRC) in Washington, DC. I would like to thank you for allowing me the opportunity to testify today on the regulation of small banks in the United States.

Background

NCRC is a national trade association representing more than 600 community-based organizations and local public agencies who work daily to promote economic justice and increase fair and equal access to credit, capital and banking services to traditionally underserved populations in both urban and rural areas.

NCRC supports long-term solutions that provide resources, knowledge, and skills to build community and individual wealth. NCRC has represented our nation's communities on the Federal Reserve Board's Consumer Advisory Council, Community Development Financial Institutions Advisory Board, Freddie Mac's Housing Advisory Council, Fannie Mae's Housing Impact Council and before the United States Congress.

NCRC works directly with the community through our services including our Consumer Rescue Fund, Minority Business Development Center, and Financial Education and Outreach initiatives. Our Consumer Rescue Fund initiative has assisted more than 500 consumers who were victims of predatory lending. We have also provided financial education to help low and moderate income people achieve homeownership and access to wealth. Additionally, we are proud to announce that we recently had our ribbon cutting ceremony for the opening of our Minority Business Development Center in Washington, DC.

Small Banks and Red Tape: CRA is the Wrong Place to Cut

Banks are most vocal about the regulatory burden of the Bank Secrecy Act and the U.S. Patriot Act. If this committee is looking to reduce burden, these are the two laws to tackle. Terrorism must be combated fiercely, but we hear from banks that the U.S. Patriot Act and the Bank Secrecy Act are crude and ineffective tools for identifying and eliminating terrorists.

Some lawmakers remain tempted to further "streamline" the Community Reinvestment Act (CRA) in an effort to reduce red tape. In my remarks today, I hope to convince you that CRA is the wrong law and regulation to scale back. CRA is instrumental to making capitalism work in all communities and helping hard working people build wealth by acquiring loans to buy homes or start small

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businesses. Moreover, as described in detail below, most banks no longer complain about the regulatory burden of CRA.

In a perfect world, we would not need CRA because discrimination would be non-existent. Unfortunately, CRA is still needed because discrimination is alive and well. CRA fights discrimination by requiring banks to serve the needs of all communities in which they are chartered. CRA requires banks to assess if the person is creditworthy regardless of who she is or where she lives. By requiring banks to lend to creditworthy people who may otherwise have been rejected due to discrimination, CRA increases efficiency and equity in the marketplace. CRA is a win-win. Consumers and communities build wealth by accessing loans. Small banks gain profitable business opportunities by working harder to serve low- and moderate-income communities.

CRA regulations require banks with assets above $250 million to provide loans, investments, services and bank branches to low- and moderate-income communities. Without CRA, enlightened smaller and mid-size banks would provide a wide array of loans and services to all communities. However, without CRA, many other smaller banks would not make loans and investments available to all communities. CRA has helped banks themselves by encouraging them to build wealth in communities, thereby making their customer base stronger. Without a comprehensive CRA, communities, particularly rural areas served by smaller banks, would suffer a new round of disinvestment, redlining, and decay.

The Baker-Hensarling Promoting Community Investment Act of 2004

Chairman Bachus, two members of your subcommittee, Reps. Baker and Hensarling, have introduced HR 3952, the Promoting Community Investment Act of 2004 that would actually promote disinvestment. Their bill would streamline CRA exams for banks with assets up to $1 billion.

Under present CRA regulations, large banks with assets of at least $250 million are rated by performance evaluations that scrutinize the level of lending, investing, and services to low- and moderate-income communities. HR 3952 would eliminate the investment and service test component of the CRA exam for banks and thrifts with assets between $250 and $1 billion. The bill would also eliminate the part of the lending test that evaluates how many community development loans a bank has made for affordable housing and economic development projects.

Streamlining CRA exams for banks with up to $1 billion dollars would mean that 93 percent of the banks or 8,667 banks in the United States would now have cursory exams. For rural America, the impact would be even more extreme. Ninety nine percent of the banks located in non-metropolitan areas would now undergo a cursory CRA review. Moreover, banks with assets up to $1 billion own

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88 percent of the branches in rural America. Without the CRA service test, the great majority of rural banks would be under no obligation to locate their branches in low- and moderate-income communities.

Banks with assets between $250 million to $1 billion control a total $758 billion in total assets. Proponents of streamlining discuss the small percentage of industry assets that would be impacted. This discussion overlooks that $758 billion in assets is larger than Bank of America, which is the third largest holding company currently, and almost as large as JP Morgan Chase, the second largest holding company in America.[1] Eliminating the requirement to make community development loans and investments for banks with assets between $250 million to $1 billion amounts to abolishing this obligation for the second or third largest bank in the country. The impacts, particularly in rural America, are profound, not minimal (see Table 1 in the Appendix for numbers of banks with assets up to $1 billion and banks with assets between $250 and $1 billion).

I next turn to the impacts of the proposed changes in the CRA regulations. I provide lots of detail about the devastating impacts of these proposals. What must be remembered is that the Baker-Hensarling bill would be exponentially more harmful than the proposed CRA changes since the bill applies to a much larger group of banks.

Proposed Changes to CRA Regulations

NCRC is pleased to testify today because this hearing immediately follows the close of the public comment period on the proposed changes to the CRA regulations. As Congress considers reacting to the proposed changes, members of Congress need to have comprehensive information concerning the dramatic impact of the proposed changes.

Since NCRC was born out of the enactment of the Community Reinvestment Act, our coalition has been urging the federal agencies to significantly amend and/or withdraw the proposed changes to the Community Reinvestment Act (CRA) regulations. NCRC and our member organizations have submitted more than 350 comment letters requesting the withdrawal of the proposed changes.

I would like to add that we are sincerely grateful to Representatives Frank, Sanders, Waters, Maloney, Gutierrez, Watt, Carson and Capuano for supporting our concerns on the proposed CRA regulations by sending a joint letter to the regulators; as well as Congresswoman Nydia Velazquez who singly wrote in to express her concerns regarding this matter. For this, we are extremely grateful for their support.

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[1] The dollar amount of assets of Bank of America and JP Morgan Chase are based on the December 2003 National Information Center database maintained by the Federal Reserve Board (via http://www.ffiec.gov).

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The proposed changes as contrary to the CRA statute, and if implemented will slow down, if not halt progress made in community reinvestment. The proposed CRA changes will also thwart the Bush Administration's goals of improving the economic status of immigrants and the creation of 5.5 million new minority homeowners by the end of this decade

Streamlined and Cursory Exams for Smaller Banks

One of the proposed changes to the CRA regulations is a more streamlined and cursory exam for banks with assets between $250 and $500 million. Curtailing these exams is unjustifiable given the serious ramifications for consumers in rural America and in several metropolitan areas. We fervently believe that the large bank exam be retained for banks between the $250 to $500 million in assets range.

Under present CRA regulations, large banks with assets of at least $250 million are rated by performance evaluations that scrutinize the level of lending, investing, and services to low- and moderate-income communities. Like the Baker and Hensarling bill, the proposed regulatory changes will eliminate the investment and service test component of the CRA exam for banks and thrifts with assets between $250 and $500 million. The community development portion of the lending test would also be abolished.

NCRC is astonished that the notice of proposed rulemaking (NPR) brushes aside the crippling impact that streamlined exams would have on the continued progress of community reinvestment. The NPR attempts to minimize the impact of the proposed change by stating that the portion of industry assets subject to the large bank exam would decline from slightly more than 90% to a little less than 90%.[2] This approach obscures the fact that the proposed changes would reduce the rigor of CRA exams for 1,111 banks that account for more than $387 billion in assets. Wells Fargo and Company, the fifth largest holding company in the United States, has assets equal to $387 billion. While the federal banking agencies would be unlikely to propose eliminating the investment and service test for a lender the size of Wells Fargo, the effect of streamlining the exams for the so-called smaller banks has virtually the same impact.

In our view, the elimination of the investment and service tests for more than 1,100 banks translates into considerably less access to banking services and capital for underserved communities. For example, these banks would no longer be held accountable under CRA exams for investing in Low Income Housing Tax Credits, which is a major source of affordable rental housing needed by large numbers of immigrants and lower income segments of the minority population.

[2] Notice of proposed rulemaking, Federal Register, Vol. 69, No. 25, Friday, February 6, 2004, p. 5738.

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Likewise, banks would no longer be held accountable for the provision of bank branches, checking accounts, Individual Development Accounts (IDAs), or debit card services.

The effectiveness of the Bush Administration's housing and community development programs would be greatly diminished as significantly fewer bank resources will be devoted to community reinvestment. Moreover, the federal banking agencies will fail to enforce CRA's statutory requirement that banks have a continuing and affirmative obligation to serve credit and deposit needs if they eliminate the community development lending, investment, and service test for a large subset of depository institutions.

Data reporting requirements regarding small business and farm loans must also remain intact for banks and thrifts with assets between $250 and $500 million. It would be terribly ironic if the federal agencies removed the small business and farm data-reporting requirement. A lack of publicly available data would eliminate the public's ability to measure whether small banks with assets between $250 and $500 million are continuing to respond to their credit needs through making critical small business and farm loans. Statistics show that small businesses and farms, particularly those in non-metropolitan areas, rely on smaller banks for access to loans. Public data disclosure is therefore critical because it is a vital means for holding smaller banks accountable in serving small businesses and farms facing a restricted choice of banks.

The presence of a holding company must remain a factor in deciding which institutions receive the streamlined small bank exam or the comprehensive large bank exam. NCRC's analysis below reveals that a great majority of banks with assets between $250 and $500 million are part of holding companies with much larger asset sizes. The assets of the holding company and the option to include affiliates on CRA exams assists small banks in making investments and community development loans. Since smaller institutions currently utilize assets of their holding companies and activities of their affiliates, providing streamlined CRA exams to these banks deprives low- and moderate-income communities of valuable resources for community development investment and lending. The current procedure of applying the large bank exam to small banks that have holding companies of $1 billion or more in assets must remain.

National Analysis Obscures Local Impacts of the Regulatory Proposal

The federal agencies' cursory reference to the relatively small amount of industry assets eligible for the streamlined exam proposal suggests that the agencies

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have not scrutinized the profound impacts on a state and local level.[3] The national perspective of the regulators is puzzling, considering that CRA ensures that local, not national, credit and deposit needs are addressed by banks and thrifts. The very essence of the streamlined exam proposal suggests that the agencies are violating their statutory responsibilities to require banks to meet local needs of all the communities in which they are chartered.

On a national level, federal agencies can perhaps dismiss the impact of the streamlined exam proposal by asserting that only 4.3 percent of the industry's assets would be covered by the cursory exams. However, using FDIC's database on depository institutions, our research reveals that the impact in terms of assets is much larger on a state, urban, and rural level.[4] For instance, in Idaho, smaller banks with assets between $250 and $500 million possess $4.6 billion in assets and control more than 55 percent of the total assets of depository institutions headquartered in the state. In Vermont, smaller banks and thrifts also control 24 percent of these assets or $1.8 billion in assets. Twenty-seven smaller banks and thrifts in Maryland have a sizable $9.6 billion in assets or 21.4 percent of the assets of depository institutions located in Maryland (see Table 2).

We also found that so-called small banks and thrifts with assets between $250 and $500 million control more than 10 percent of total depository institution assets in 20 states. In other words, the so-called small bank and thrifts control more than twice their national share of 4 percent of assets in almost half of the states. In our opinion, ten percent of total assets on a statewide level is quite significant. If by some reason these banks were to close, the financial resources of banks available to state residents for investment purposes would decline suddenly by 10 percent. The obvious conclusion is that this means that there will be much less investment available for commercial and residential development. Yet, the elimination of 10 percent of bank assets for investment and community development lending is precisely what is being proposed for low- and moderate-income communities in about half of the states.

The proposed streamlined exam would have the most devastating impact for rural America since the so-called small banks have their largest presence in non-metropolitan areas. According to the FDIC database, small banks and thrifts with assets between $250 and $500 million hold $126 billion of total assets of banks

[3] During the FDIC Board meeting on January 20, 2004 considering the proposed changes, new Board member Thomas Curry asked FDIC staff if staff had conducted an analysis of the impacts of the changes. Staff replied that they had not.
[4] The FDIC database is the Statistics on Depository Institutions (SDI), which is updated on a monthly basis according to the FDIC web page (http://www.fdic.gov). NCRC downloaded the database in late February 2004. The database assigns all of the bank assets to the state in which a bank is located. The publicly available FDIC databases do not provide sufficient detail to determine if banks distribute their assets among their interstate branches. For the purposes of this comment letter, NCRC assumes all of the bank assets are located in the states in which the banks are headquartered.

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located in rural areas. This amount is 18.8 percent of all bank assets in rural areas, or more than 4 times the portion of assets that smaller banks control in the nation as a whole. In other words, the impact of streamlining CRA exams will be about 4 times worse (in terms of assets available for bank investments and services) in rural areas than in the nation as a whole.

In eight states, institutions with $250 to $500 million in assets control more than one third of the bank assets in rural areas. In Vermont, just five smaller banks possess $1.7 billion in assets or more than 53 percent of the assets in rural counties in that state. Similarly, in Utah and Idaho, banks and thrifts with assets between $250 and $500 million control more than 50 percent of all assets in rural areas. The "smaller" banks and thrifts in Massachusetts, Washington, Virginia, Alaska, Maryland, and Maine possess between 30 to 44 percent of the assets in non-metropolitan counties (see Table 3).

Banks and thrifts with assets between $250 and $500 million control more than 20 percent of the total assets held by depository institutions in rural areas in 18 states. These banks and thrifts control 10 percent or more of the assets in rural areas in 41 states. While the regulatory agencies refer to these institutions as small banks, it is clear that they are a major source of investments and services to these rural areas. Streamlining their CRA exams would result in disinvestment from rural parts of the country, an area least able to deal with the loss of bank investment and community development lending.

Our research shows that for urban areas the impact of the proposed streamlining is greater than would be expected. In fourteen states, banks and thrifts with assets between $250 and $500 million control 10 percent or more of all assets of depository institutions located in metropolitan areas. In Colorado, small banks possess a large $8.7 billion in assets or 22 percent of all the assets of lenders located in metropolitan areas. Similarly, in Maryland, small banks and thrifts control $7.5 billion in assets or 19.4 percent of all the bank assets in urban areas (see Table 4).

When considering the number of lenders as compared to assets, this impact is dramatic in a number of states throughout the country. Overall, the proposal would eliminate the large bank exam for 20 percent or more of the lenders located in 12 states since these lenders have assets between $250 and $500 million. Likewise, the proposal would eliminate the large bank exam for 10 percent or more of the lenders in 35 states. If implemented, the proposal will wipe out the large bank exam for 20 percent or more of the rural-based banks in 15 states. In seven states, more than 30 percent of the lenders based in rural counties would be exempted from the large bank exam. For example, 33 percent, or 20 of the 60 banks and thrifts located in rural parts of Virginia have assets between $250 and $500 million, and would no longer have to undergo the large bank exam. We also believe that the impact of these proposed rules are

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extremely significant in metropolitan areas since 20 percent or more of the lenders in urban areas in 16 states would be exempt from the large bank exam.

Reductions in Community Development Investments by the Regulatory Proposal

NCRC analyzed the CRA exams of 40 banks and thrifts with assets between $250 and $500 million to assess the impacts on the level of investments and community development lending if the small bank exam applied to these institutions (see Table 5 for a list of lenders in the sample). The analysis scrutinized exams in four states (Vermont, Maryland, Colorado, and Arkansas) in which smaller banks controlled the largest percentage of assets.[5]

The analysis reinforces the devastating impact of the proposed streamlining. The 40 banks and thrifts in the sample made a total of $69,450,000 in qualified investments, according to their CRA exams. These institutions also issued $92,642,000 in community development loans. The community development lending and investment combined equals more than $162 million. For the four states of Vermont, Maryland, Colorado and Arkansas, $162 million in community development lending and investment represents a substantial source of revitalization financing. The loss of financing would be felt many times over since community development investing and lending of this magnitude creates hundreds, if not thousands of jobs, and increases the purchasing power of local workers and communities.

Assuming that these banks and thrifts are representative of all depository institutions with assets between $250 and $500 million, the total amount of community development lending and investing by the "smaller" lenders equals more than $4.5 billion. This is the amount of lending and investment that occurs roughly every two to three years, or approximately the time period between CRA exams. Eliminating the large bank lending and investment test for these lenders translates into dramatically fewer dollars in community development loans and investments for low- and moderate-income communities. Even if NCRC's sample is not statistically representative, the order of magnitude in lost investments and loans is likely to be in the hundreds of millions, if not billions of dollars. Eliminating the investment and community development lending tests reduces the level of investment and community development loan dollars by at least half in the NCRC sample of CRA exams.

Scrutinizing the Investment Tests of the 40 banks and thrifts in the sample, NCRC found that the average investment amount of the 11 depository institutions

[5] Idaho is that state in which smaller banks and thrifts control the largest percentage of assets. We were unable to find large bank CRA exams for these institutions; the institutions had assets under $250 million at the time of their most recent CRA evaluations and thus were examined under the small bank exam.

receiving an Outstanding rating on the Investment Test was $3.7 million or 1.36 percent of their assets. The average investment of the 10 depository institutions with High Satisfactory ratings on the Investment Test was $1.6 million or .65 percent of their assets. In sharp contrast, investment dollars and percent of assets was less than half that level for banks with lower ratings. The 16 banks and thrifts with Low Satisfactory ratings made an average investment amount of just $734,000 or a mere .21 percent of their assets. The 3 banks and thrifts with Needs-to-Improve ratings made a measly $171,000 in qualified investments or .06 percent of their assets.

The upshot of this analysis is that it is very likely that eliminating the investment test for banks and thrifts with assets between $250 and $500 million would reduce their investments in low- and moderate-income communities by at least half. Banks with High Satisfactory ratings made twice as many qualified investments (measured in terms of dollars) than banks with Low Satisfactory ratings. The differences are even more extreme if comparisons are made among banks with Outstanding, High Satisfactory, Low Satisfactory, and Needs to Improve ratings.

Therefore, a conservative estimate uses the difference between banks with High and Low Satisfactory ratings. In the absence of Investment Tests, it is reasonable to assume that banks with High Satisfactory ratings would invest at the level of banks with Low Satisfactory ratings. This suggests that banks with High Satisfactory ratings would reduce their level of investments by half. Since the comparison between banks with High and Low Satisfactory ratings is a conservative estimate of impacts, it is likely that all banks (regardless of their ratings) would cut the dollar amount of their qualified investments by half in the absence of an investment test.

Reductions in Community Development Lending by the Regulatory Proposal

Our research reveals that the decrease in community development lending is even greater for NCRC's sample of 40 banks with assets between $250 and $500 million. The five depository institutions with an Outstanding rating on the lending test had an average community development lending level of $4.7 million. Their ratio of community development lending to assets was 1.46 percent. The sixteen banks with High Satisfactory ratings on their lending test had an average of $3.2 million in community development loans and a community development lending to asset ratio of 1.03 percent. In sharp contrast, the nineteen banks with Low Satisfactory ratings on the lending test made an average of only $950,000 in community development loans and had a dismal .3 percent ratio of community development loans to assets.

In this case, banks and thrifts with Outstanding and High Satisfactory ratings on

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their lending tests made between 3 and 4 times the level of community development lending as institutions with Low Satisfactory ratings. Again, a conservative estimate of the impact of eliminating the community development lending test would be the difference between High and Low Satisfactory institutions. Assuming that this difference would apply to all institutions regardless of their ratings, the level of community development lending would be two thirds less if the federal agencies eliminate the community development lending test of the large bank exam for institutions with assets between $250 and $500 million.

Concrete Examples of Community Development Loans and Investments Likely to Disappear

Quantifying the proposal's likely decreases in reinvestment is compelling, but concrete examples clearly and powerfully illustrate the looming harm of the proposals. Simply put, the streamlining would result in less affordable rental housing, fewer homeless shelters, less economic development projects, and fewer community health centers and other facilities. On most of these projects, banks realize a profit. Projects that do not generate economic returns, such as homeless shelters, still benefit banks and their local communities by reducing poverty and deprivation.[6] If the federal agencies believe that it is desirable to substantially decrease affordable housing and economic development activities, then they should proceed with their proposed streamlining. If, on the other hand, the regulators come to believe that the societal and human costs of streamlining are too high, they should immediately abandon their proposal.

In Maryland, banks with assets between $250 and $500 million have been motivated by CRA exams to undertake a variety of critical community development loans and investments. For instance, Arundel Federal Savings Bank invested $625,000 in Maryland Community Development Administration bonds and purchased $20,000 of tax credits from the Anne Arundel County Chapter of Habitat for Humanity. Bradford Bank originated a $2.5 million loan to refinance and renovate shopping centers in eastern Baltimore County. Carrollton Bank purchased two Fannie Mae Mortgage Back Securities totaling $3 million, which provided funds to finance mortgages for multi-family housing dedicated to those with limited incomes. Carrollton also made available two lines-of-credit totaling $800,000 to a nonprofit organization that operates a Baltimore County residential treatment center for low-income adolescent females.

[6] In terms of economic theory, CRA has encouraged banks to "internalize" the positive externalities of some social projects that otherwise would not be undertaken since no party realizes private profit from them.

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In Colorado, Pueblo Bank & Trust Company's overall level of community development lending has been extraordinary, according to the most recent CRA exam. In 2001 and 2002, Pueblo B&T originated 57 community development loans totaling approximately $24,422,000. Many of these loans went to providing affordable housing to low- and moderate- income individuals. Community development loans equaled an incredible 7 percent of Pueblo's assets, about 5 times the portion of assets that banks with Outstanding ratings on the lending test in NCRC's sample devote to community development lending. As civic minded as Pueblo Bank & Trust may be, it is unlikely that they would continue their impressive performance should the community development lending and investment tests be abolished.

In January 1997, First Bank of South Jeffco, Colorado purchased $800,000 in a Sheridan School District, Arapahoe County, Refunding and Improvement Bond. Proceeds of the bonds paid the cost of capital improvements at elementary, middle, and high schools, and an early education center that houses a head start program. In 1999, First Bank purchased a portion of a 99 percent limited partnership interest in the Littleton Creative Housing Limited Partnership for $2,800,000. The partnership owns and operates the Libby Bortz Low-Income Housing Assisted Living Center.

Also, in Colorado, First Bank of Boulder purchased a total of $3,700,000 in Colorado Housing and Finance Authority (CHFA) Single-Family Revenue Bonds since its last evaluation. The bond programs are specifically targeted for low- and moderate-income individuals/families in Colorado.

In Arkansas, Citizens Bank originated $3,100,000 in loans for White River Medical Center, according to the most recent CRA exam. The two loans provided financing for working capital and construction of nursing home and retirement facilities, all of which primarily served low- and moderate-income individuals and Medicaid patients. Finally, First National Bank of Springdale originated 54 community development loans totaling $4.3 million. FNB Springdale's community development loan portfolio consists of short-term affordable housing construction loans.

As these examples illustrate, elimination of the community development lending and investment test entails the elimination of critical affordable housing, economic development, and community facility projects. In many small and medium-sized metropolitan areas and rural counties, it is unlikely that banks still subject to the large bank exam would step in and fill the gap in community development lending and investing. The banks with assets between $250 and $500 million are most likely to have assessment areas that are confined to the smaller metropolitan areas and rural communities. In contrast, the larger banks are likely to have assessment areas that include more geographical areas, meaning that they are less focused on the credit and development needs of the

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areas served by banks with assets of $250 to $500 million. The loss of community development lending and investing is likely to be permanent in parts of the country least able to withstand a withdrawal of capital and credit.

Elimination of Service Test Will Reduce Access to Branches under the Regulatory Proposal

The FDIC database also reveals the dramatic impacts that eliminating the service test will have on access to branches. If the federal agencies eliminate the service test, it is quite likely that small banks will de-emphasize their branching network and/or reduce the number of services and products that the branches offer to low- and moderate-income communities.

For instance, in the United States as a whole, small banks and thrifts with assets between $250 and $500 million own almost 10 percent of the branches. They own 7,985 of the 87,357 branches serving the general public.[7] NCRC believes that any subset of institutions that control either 10 percent of the assets or 10 percent of the branches in a geographical area have a significant impact in terms of access to credit, investments and banking services. Therefore, when just confining the analysis to a national level, the large bank exam and the service test must not be eliminated for banks and thrifts with assets between $250 and $500 million since these institutions have a significant branching presence across the country.

When this analysis is conducted on a state level, the branch presence is even larger for the so-called smaller banks and thrifts. In 25 states, the smaller banks have more than 10 percent of the branches. In 10 states, they own 15 percent or more of the branches. The branch presence of the smaller banks is dominant in the more rural states. In Maine, the "smaller" banks own 29 percent or 146 of the 504 branches in the state. Likewise, they own 19.8 percent and 17.6 percent of the branches in South Dakota and Idaho, respectively (see Table 6).

The impact of the proposed abolition of the service test is the most severe in rural areas because of the large presence of branches owned by the smaller banks and thrifts. Banks and thrifts with assets between $250 and $500 million control more than 10 percent of the non-metropolitan branches in 32 states. They possess 20 percent or more of the rural branches in 7 states. In Virginia, for example, the "smaller" banks and thrifts own 169 of the 697 branches or 24.2 percent of the rural branches. Likewise, in New Hampshire, they control 51 of the 216 branches or 23.6 percent of the rural branches (see Table 7).

[7] NCRC used the FDIC's Summary of Deposits Database for the analysis. The most recent data available for downloading was June 30, 2003. NCRC eliminated branches from our sample that did not accept deposits and serve the public. These included administrative offices, trust offices, messenger offices, loan production offices, and consumer credit offices.

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The effect of the streamlining on urban areas is also significant. In nineteen states, small banks and thrifts with assets between $250 and $500 million own 10 percent or more of the branches in metropolitan areas. Not surprisingly, the more rural states such as Wyoming and Montana have significant percentages of metropolitan area branches owned by the smaller banks. Even more urban states including Massachusetts and Missouri have a significant portion of metropolitan branches owned by the smaller banks (see Table 8).

The impact by deposits is also striking. Across the United States, the so-called smaller banks and thrifts with assets between $250 and $500 control more than $302 billion in deposits. In seventeen states, they control more than 10 percent of the deposits. Again, the impacts of the streamlining would be most crippling in rural areas. In 36 states (more than two thirds of all states), the "smaller" banks and thrifts have more than 10 percent of the deposits in rural areas. In 18 states, they control more than 15 percent of the deposits. For instance, in Maryland, they control more than $1.2 billion of the $5.6 billion or 21 percent of deposits collected by rural branches. The smaller banks and thrifts control more than 20 percent of the rural deposits in Maine, South Dakota, Virginia, Vermont, Maryland, Idaho, and New Mexico.

These states can ill afford the smaller banks and thrifts neglecting the deposit and service needs of rural residents. Payday and subprime lenders will sense even more of a market opportunity and replace mainstream bank products with higher rate consumer and home loans. The resulting reductions of community and consumer wealth will further retard economic development efforts.

Bank Holding Company Must Remain a Consideration

To reiterate, removing the bank holding company as a factor in differentiating between small and large banks will allow many institutions with sufficient resources to unfairly enjoy the streamlined test and abdicate their responsibilities for providing branches and community development investments and loans in low- and moderate-income communities. Using FDIC's database, NCRC calculated that 815 of the 1,111 small banks and thrifts with assets between $250 and $500 million are owned by holding companies. More than 73 percent of the so-called smaller banks and thrifts are owned by holding companies. This is a higher percentage than all banks and thrifts; about 70 percent of all banks and thrifts are owned by holding companies.

Not only are a greater percentage of smaller institutions owned by holding companies, NCRC's sample of 40 CRA exams reveals a substantial amount of holding company assets available to the smaller institutions. In the sample, 37 of 40 banks in the states of Arkansas, Colorado, Maryland, and Vermont had holding companies. This is the great majority or 92 percent of the banks in the

sample. While about three quarters of the smaller banks and thrifts nationwide have holding companies, the portion is even greater in a number of states including those in the NCRC sample of CRA exams.

Some holding companies in NCRC's sample of CRA exams had considerable assets well above $1 billion. These holding companies include UMB Financial with $8 billion, Mercantile Bankshares with $9.9 billion, Fulton Financial with $6.9 billion, First Bank Holding Company of Colorado with $5.7 billion, First Tennessee National Corporation with $23 billion, and First Nations of Nebraska with $9.7 billion. In a couple of cases, one holding company owned a sizable number of banks in the NCRC sample. For example, in Colorado, First Bank Holding Company owned 11 of the 15 banks in that state. Similarly, in Maryland, Mercantile Bankshares owned 6 of 17 banks. Moreover, in the Colorado exams of banks owned by First Bank Holding Company, the banks often claimed credit for community development loans and investments undertaken by affiliates.

In other words, the holding company made its resources available to their banks for CRA exam purposes. Eliminating holding companies as a factor in differentiating between small and large banks results in major financial institutions abdicating their community reinvestment obligations. This greatly diminishes the amount of holding company assets available to businesses and consumers in low- and moderate-income communities.

Burden Argument

The benefits of maintaining the large bank CRA exams are substantial, but are still likely to be underestimated by the conservative approach of the NCRC analysis. The application of the large bank CRA exam to banks and thrifts with assets between $250 and $500 million has made thousands of branches and billions of dollars in community development loans and investments available to low- and moderate-income communities. Consequently, the proposed elimination of the large bank exam for the so-called smaller banks poses the threat of withdrawing access to a substantial number of branches and financial resources for reinvestment.

The burden of large bank exams for the so-called smaller banks appears to be minimal while the benefits of the exams are profound for low- and moderate-income communities. During a session held by the FDIC on regulatory streamlining, Charlotte Bahin, Senior Vice President of Regulatory Affairs of America's Community Bankers, stated publicly that most smaller institutions no longer complain about the burden of CRA exams.[8] According to Ms. Bahin, smaller banks worry that they are compared to larger banks on CRA exams, but they are not concerned about the CRA exam process, in and of itself. With

[8] FDIC Session on the Economic Growth and Regulatory Paperwork Reduction Act, February 20, 2004.

almost a decade of experience with CRA exams, the smaller institutions are now accustomed to the exams.

The comments of Ms. Bahin regarding perceptions of unfair comparisons to larger banks on CRA exams can be readily put to ease by appropriate CRA examination procedures. The CRA exams scrutinized by NCRC compared small banks against other smaller banks. Moreover, the examiners also remark that they take into account, when appropriate, how the presence of large banks can impact smaller bank performance on any part of the exam. This procedure is referred to in CRA jargon as the CRA performance context.

The time spent by CRA examiners suggests that the CRA examination process for banks with assets between $250 and $500 million is considerably less time consuming than for banks with a few billion dollars in assets. According to a CRA examiner interviewed by NCRC, a CRA exam for a bank with half a billion dollars in assets consumes 10 to 15 days of examiner staff time. In contrast, a CRA exam of a bank with $5 to $10 billion in assets consumes about 20 to 50 days of staff time. Finally, a CRA exam of a bank with more than $40 billion in assets consumes about 100 days of staff time. It is reasonable to assume that CRA examiner time serves as a proxy for bank staff time in compiling data and preparing for a CRA exam. Therefore, a CRA exam for a bank with more than $5 billion in assets probably entails between 2 to 5 times the staff time as a CRA exam of a bank with half a billion in assets. This analysis suggests that CRA exams are already streamlined for institutions with assets between $250 and $500 million in assets.

Another complaint is that data reporting requirements are overly time consuming for smaller banks. However, the revolution in computerization and the Internet has benefited even the "smaller" banks in terms of data collection. Moreover, making a loan is a complicated process, requiring extensive documentation of key borrower and property characteristics. Adding relatively few data elements relating to the ethnicity and income level of the borrower and neighborhood is unlikely to overload the data collection capacity of smaller banks. Finally, smaller banks make fewer loans than their larger counterparts. They may have to track a few hundred loans a year, whereas their larger counterparts must develop databases monitoring tens of thousands of annual loans.

Banks of all sizes and types have a keen interest in developing databases for their marketing purposes. They also use data to compare their position in the market versus their competitors. Regardless of whether they publicly disseminate their data, the vast majority of banks are collecting and analyzing data. Any additional costs of CRA or HMDA data requirements are not substantial considering the costs banks are already incurring for the development of their own internal databases.

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Capitalism thrives on information; public disclosure of information improves the efficiency of markets. Data collection and dissemination makes capitalism work for everyone.

Of course, regulations do impose some costs on banks. NCRC believes, however, that an objective cost-benefit analysis would reveal that the benefits massively outweigh the costs of large bank CRA exams for both banks and the public at large. NCRC believes that the regulatory agencies, themselves, must conduct a comprehensive cost-benefit analysis in considering their streamlined proposal. NCRC contacted senior officials of the federal banking agencies, who told NCRC that the agencies have not conducted cost-benefit analyses.

Smaller banks have complained much less frequently about CRA exams than they did a number of years ago. Their lingering concern about unfair comparisons does not appear to be a reality in most CRA exams. In the final analysis, burdens associated with large bank CRA exams have more to do with perception than reality. In contrast, the benefits of large bank exams are real, easily documented, and profound. Low- and moderate-income communities have access to billions of dollars in capital and credit, which would likely disappear as the NCRC analysis above suggests. Banks themselves have realized substantial amounts of profits as CRA exams have motivated them to find safe and sound lending, investing, and branching opportunities in low- and moderate-income communities.

Finally, we find it strange that the regulators are proposing to considerably streamline CRA exams for a large segment of banks when the banks themselves do not place CRA at the top of their list of "burdens." According to the federal agency web site regarding the Economic Growth and Regulatory Paperwork Reduction Act, banks regard the Bank Secrecy Act (BSA) and Currency Transaction Reports as the "most burdensome regulations for the banking community." Banker "outreach" meetings suggest that the "cost of compliance is high…(the BSA regulations) are ineffective…and overly complex." Also, high on the list for burden was the "Know Your Customer" requirements of the USA Patriot Act.[9]

Conclusion

In contrast to the BSA regulations, the CRA regulations are quite effective and not overly complex. We believe that many small community banks are supportive of their communities. However, if the proposed changes to the CRA regulations are implemented, these banks will no longer have an affirmative obligation to serve the needs of the communities in which they are chartered and from which they take deposits. They will not be held accountable by federal

[9] See http://www.EGRPRA.Gov and go to Banker Outreach Meetings.

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regulatory agencies for making community development loans, investments, services, and branches available to low- and moderate-income communities. The end result is a slowing down, if not a halt, of the progress in reinvestment for rural areas and smaller towns, in particular. We firmly believe that the CRA regulations are the wrong regulations to savage by the proposed streamlining.

Congress' intent was clear when it passed CRA. Congress imposed an "affirmative and continuing obligation" for banks to serve the credit and deposit needs of low- and moderate-income communities. A less rigorous exam for over 1,100 financial institutions lessons that obligation and flies in the face of both the intent and the spirit of Congress' passage of CRA. Those charged with enforcing CRA ought to be proposing efforts to expand the law's effectiveness, not lessening it. Congress should take immediate steps to reign in the federal banking agencies and end their proposed plans to weaken CRA enforcement.

Thank you Mr. Chairman.

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Appendix: Tables Showing Impact of Streamlined CRA Exams

NCRC Analysis
Table 1: Impact of HR 3952, Baker-Hensarling Bill

Number of Lenders

	Lenders with Assets $0 - $1 Billion		Lenders with Assets $250 Million - $1 Billion		Number of Lenders (Total)
	#	%	#	%	
United States	8,667	93.69%	1,647	17.80%	9,251
Rural United States	4,609	99.03%	496	10.66%	4,654
Urban United States	4,058	88.27%	1,151	25.04%	4,597

Number of Branches

	Branches with Assets $0 - $1 Billion		Branches with Assets $250 Million - $1 Billion		Number of Branches (Total)
	#	%	#	%	
United States	33,640	38.23%	14,926	16.96%	87,992
Rural United States	16,039	88.26%	5,264	28.97%	18,172
Urban United States	17,601	25.21%	9,662	13.84%	69,820

Dollar Amount of Assets

	Amount of Assets of Lenders with Assets $0 - $1 Billion		Amount of Assets of Lenders with Assets $250 Million - $1 Billion		Amount of Assets (Total)
	#	%	#	%	
United States	$ 1,391,540,983	15.54%	$ 758,603,714	8.47%	$ 8,955,659,215
Rural United States	$ 539,645,805	80.23%	$ 210,781,343	31.34%	$ 672,611,716
Urban United States	$ 851,895,178	10.28%	$ 547,822,371	6.61%	$ 8,283,047,499

NCRC Analysis: Impact of Regulatory Proposal

Table 2: Number and Assets of "Small" Lenders by State

	Number of Lenders ($250m-$500m)	Total Number of Lenders	Percent of Lenders	Assets ($000's) ($250m-$500m)	Total Assets ($000's)	Percent of Assets
United States	1,111	9,251	12.01%	$ 387,196,665	$ 8,955,659,215	4.32%
Idaho	7	18	38.89%	$ 2,533,662	$ 4,568,540	55.46%
Vermont	5	19	26.32%	$ 1,761,412	$ 7,338,177	24.00%
Maryland	27	124	21.77%	$ 9,647,197	$ 45,015,479	21.43%
Colorado	31	180	17.22%	$ 10,172,236	$ 48,947,200	20.78%
Arkansas	22	171	12.87%	$ 7,704,654	$ 37,380,102	20.61%
Montana	8	82	9.76%	$ 2,750,362	$ 14,900,690	18.46%
West Virginia	9	74	12.16%	$ 3,117,444	$ 18,518,759	16.83%
Missouri	39	376	10.37%	$ 12,919,400	$ 84,561,399	15.28%
New Mexico	8	60	13.33%	$ 2,910,631	$ 19,550,975	14.89%
Louisiana	22	171	12.87%	$ 7,618,347	$ 51,580,423	14.77%
Iowa	22	426	5.16%	$ 7,820,798	$ 55,727,527	14.03%
Kentucky	19	247	7.69%	$ 6,504,737	$ 50,018,071	13.00%
Maine	13	40	32.50%	$ 4,868,058	$ 39,235,614	12.41%
Wyoming	3	47	6.38%	$ 941,746	$ 7,590,646	12.41%
Kansas	18	379	4.75%	$ 6,209,123	$ 52,172,324	11.90%
Wisconsin	36	311	11.58%	$ 12,552,084	$ 106,776,671	11.76%
Florida	35	303	11.55%	$ 12,040,462	$ 108,052,343	11.14%
Mississippi	13	104	12.50%	$ 4,415,925	$ 39,675,187	11.13%
Massachusetts	60	211	28.44%	$ 21,480,603	$ 204,812,470	10.49%
Oregon	7	39	17.95%	$ 2,278,601	$ 22,393,760	10.18%
New Hampshire	9	32	28.13%	$ 2,912,926	$ 29,179,696	9.98%
South Carolina	12	98	12.24%	$ 3,841,860	$ 38,487,432	9.98%
Tennessee	34	208	16.35%	$ 11,833,085	$ 118,649,563	9.97%
Nebraska	11	273	4.03%	$ 4,266,126	$ 49,143,332	8.68%
Minnesota	27	487	5.54%	$ 9,235,985	$ 111,105,470	8.31%
Georgia	49	342	14.33%	$ 16,984,641	$ 212,823,548	7.98%
Virginia	42	146	28.77%	$ 13,737,936	$ 173,011,884	7.94%
Oklahoma	14	278	5.04%	$ 4,380,050	$ 55,786,758	7.85%
New Jersey	30	146	20.55%	$ 11,149,951	$ 149,078,857	7.48%
Texas	48	706	6.80%	$ 16,422,690	$ 221,065,554	7.43%
Pennsylvania	62	277	22.38%	$ 21,782,712	$ 295,517,727	7.37%
Connecticutt	10	66	15.15%	$ 3,649,241	$ 55,023,646	6.63%
Indiana	25	207	12.08%	$ 8,746,936	$ 132,321,470	6.61%
Illinois	91	779	11.68%	$ 32,196,613	$ 533,356,954	6.04%
Washington	13	100	13.00%	$ 4,600,632	$ 80,377,066	5.72%
North Dakota	3	105	2.86%	$ 1,090,982	$ 20,144,999	5.42%
Michigan	28	179	15.64%	$ 9,966,374	$ 191,797,205	5.20%
						National Average
Alaska	1	8	12.50%	$ 314,150	$ 7,544,834	4.16%
South Dakota	7	95	7.37%	$ 2,591,060	$ 72,459,650	3.58%
Arizona	4	50	8.00%	$ 1,646,104	$ 55,880,766	2.95%
Hawaii	2	9	22.22%	$ 871,600	$ 31,412,219	2.77%
Utah	9	62	14.52%	$ 3,498,980	$ 136,825,736	2.56%
Alabama	14	162	8.64%	$ 4,675,323	$ 211,837,870	2.21%
Nevada	3	37	8.11%	$ 1,076,117	$ 51,574,457	2.09%
Ohio	39	307	12.70%	$ 13,314,704	$ 639,632,014	2.08%
California	51	315	16.19%	$ 18,208,173	$ 939,874,533	1.94%
Delaware	7	34	20.59%	$ 2,398,384	$ 213,034,239	1.13%
New York	46	217	21.20%	$ 15,907,570	$ 1,724,848,047	0.92%
North Carolina	15	106	14.15%	$ 5,359,251	$ 1,095,901,497	0.49%
Rhode Island	1	15	6.67%	$ 289,027	$ 210,916,071	0.14%
American Samoa	0	1	0.00%	$ -	$ 83,268	0.00%
District of Columbia	0	5	0.00%	$ -	$ 805,296	0.00%
Federated States of Micronesia	0	1	0.00%	$ -	$ 86,117	0.00%
Guam	0	3	0.00%	$ -	$ 953,777	0.00%
Puerto Rico	0	11	0.00%	$ -	$ 76,174,617	0.00%
Virgin Islands	0	2	0.00%	$ -	$ 126,689	0.00%

Source: FDIC Statistics on Depository Institutions database

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NCRC Analysis: Impact of Regulatory Proposal
Table 3: Number and Assets of "Small" Lenders in Rural Areas

	Number of Lenders ($250m-$500m)	Total Number of Lenders	Percent of Lenders	Assets ($000's) ($250m-$500m)	Total Assets ($000's)	Percent of Assets
United States	371	4,654	7.97%	$ 126,459,782	$ 672,611,716	18.80%
Vermont	5	16	31.25%	$ 1,761,412	$ 3,262,306	53.99%
Utah	2	12	16.67%	$ 821,962	$ 1,609,092	51.08%
Idaho	5	13	38.46%	$ 1,727,137	$ 3,450,581	50.05%
Massachusetts	7	17	41.18%	$ 2,422,129	$ 5,572,200	43.47%
Washington	9	29	31.03%	$ 3,183,814	$ 7,961,931	39.99%
Virginia	20	60	33.33%	$ 6,137,611	$ 15,789,878	38.87%
Alaska	1	4	25.00%	$ 314,150	$ 864,838	36.32%
Maryland	6	21	28.57%	$ 2,105,129	$ 6,138,358	34.29%
Maine	8	29	27.59%	$ 2,922,196	$ 9,165,670	31.88%
Louisiana	8	90	8.89%	$ 2,990,771	$ 10,376,033	28.82%
South Dakota	7	78	8.97%	$ 2,591,060	$ 9,006,364	28.77%
Ohio	20	131	15.27%	$ 6,953,693	$ 24,514,491	28.37%
South Carolina	7	50	14.00%	$ 2,225,969	$ 8,533,706	26.08%
Arkansas	12	124	9.68%	$ 4,319,163	$ 17,260,988	25.02%
Georgia	21	199	10.55%	$ 7,340,597	$ 29,941,508	24.52%
Florida	5	42	11.90%	$ 1,764,698	$ 7,345,595	24.02%
Tennessee	13	129	10.08%	$ 4,476,720	$ 19,642,975	22.79%
Nebraska	9	226	3.98%	$ 3,504,064	$ 16,003,739	21.90%
Montana	4	67	5.97%	$ 1,358,536	$ 6,989,091	19.44%
Michigan	8	78	10.26%	$ 2,501,011	$ 13,220,856	18.92%
						National Average
Pennsylvania	17	65	26.15%	$ 5,515,857	$ 30,059,343	18.35%
Kentucky	13	175	7.43%	$ 4,239,471	$ 23,244,284	18.24%
New Mexico	5	42	11.90%	$ 1,745,331	$ 9,700,592	17.99%
Illinois	16	350	4.57%	$ 5,740,872	$ 31,930,641	17.98%
California	3	13	23.08%	$ 1,006,290	$ 5,701,016	17.65%
Wisconsin	10	171	5.85%	$ 3,486,091	$ 19,802,105	17.60%
Oregon	4	15	26.67%	$ 1,273,619	$ 7,448,168	17.10%
West Virginia	3	53	5.66%	$ 1,053,245	$ 6,171,777	17.07%
New York	9	44	20.45%	$ 3,165,689	$ 19,159,089	16.52%
Indiana	10	99	10.10%	$ 3,347,527	$ 21,293,756	15.72%
Colorado	5	87	5.75%	$ 1,471,981	$ 9,513,453	15.47%
Alabama	6	102	5.88%	$ 2,033,922	$ 13,388,996	15.19%
Missouri	12	229	5.24%	$ 3,882,853	$ 25,627,925	15.15%
Mississippi	12	90	13.33%	$ 4,112,492	$ 27,793,513	14.80%
Kansas	9	290	3.10%	$ 3,058,222	$ 20,716,151	14.76%
Oklahoma	8	182	4.40%	$ 2,465,909	$ 17,322,782	14.24%
Minnesota	9	309	2.91%	$ 3,138,180	$ 22,690,785	13.83%
Texas	14	372	3.76%	$ 4,645,704	$ 35,130,212	13.22%
Iowa	11	334	3.29%	$ 3,648,792	$ 29,739,819	12.27%
North Dakota	2	84	2.38%	$ 714,623	$ 6,045,527	11.82%
New Hampshire	7	22	31.82%	$ 2,323,908	$ 20,251,295	11.48%
Wyoming	1	39	2.56%	$ 329,810	$ 4,598,976	7.17%
North Carolina	2	37	5.41%	$ 721,981	$ 10,904,282	6.62%
Connecticut	3	14	21.43%	$ 952,307	$ 15,335,427	6.21%
Delaware	3	5	60.00%	$ 963,284	$ 19,702,914	4.89%
Virgin Islands	0	2	0.00%	$ -	$ 126,689	0.00%
Rhode Island	0	3	0.00%	$ -	$ 1,102,713	0.00%
Puerto Rico	0	0	0.00%	$ -	$ -	0.00%
New Jersey	0	0	0.00%	$ -	$ -	0.00%
Nevada	0	4	0.00%	$ -	$ 267,501	0.00%
Hawaii	0	0	0.00%	$ -	$ -	0.00%
Guam	0	3	0.00%	$ -	$ 953,777	0.00%
Federated States of Micronesia	0	1	0.00%	$ -	$ 86,117	0.00%
Arizona	0	2	0.00%	$ -	$ 68,623	0.00%
American Samoa	0	1	0.00%	$ -	$ 83,268	0.00%
District of Columbia	0	0		$ -	$ -	

Source: FDIC Statistics on Depository Institutions database

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NCRC Analysis: Impact of Regulatory Proposal
Table 4: Number and Assets of "Small" Lenders in Urban Areas

	Number of Lenders ($250m-$500m)	Total Number of Lenders	Percent of Lenders	Assets ($000's) ($250m-$500m)	Total Assets ($000's)	Percent of Assets
United States	740	4,597	16.10%	$ 260,736,883	$ 8,283,047,499	3.15%
Idaho	2	5	40.00%	$ 806,525	$ 1,117,959	72.14%
Colorado	26	93	27.96%	$ 8,700,255	$ 39,433,747	22.06%
Wyoming	2	8	25.00%	$ 611,936	$ 2,991,670	20.45%
Maryland	21	103	20.39%	$ 7,542,068	$ 38,877,121	19.40%
Montana	4	15	26.67%	$ 1,391,826	$ 7,911,599	17.59%
Arkansas	10	47	21.28%	$ 3,385,491	$ 20,119,114	16.83%
West Virginia	6	21	28.57%	$ 2,064,199	$ 12,346,982	16.72%
Iowa	11	92	11.96%	$ 4,172,006	$ 25,987,708	16.05%
Missouri	27	147	18.37%	$ 9,036,547	$ 58,933,474	15.33%
New Mexico	3	18	16.67%	$ 1,165,300	$ 9,850,383	11.83%
Louisiana	14	81	17.28%	$ 4,627,576	$ 41,204,390	11.23%
Wisconsin	26	140	18.57%	$ 9,065,993	$ 86,974,566	10.42%
Florida	30	261	11.49%	$ 10,275,764	$ 100,706,748	10.20%
Kansas	9	89	10.11%	$ 3,150,901	$ 31,456,173	10.02%
Massachusetts	53	194	27.32%	$ 19,058,474	$ 199,240,270	9.57%
Kentucky	6	72	8.33%	$ 2,265,266	$ 26,773,787	8.46%
New Jersey	30	146	20.55%	$ 11,149,951	$ 149,078,857	7.48%
Tennessee	21	79	26.58%	$ 7,356,365	$ 99,006,588	7.43%
Minnesota	18	178	10.11%	$ 6,097,805	$ 88,414,685	6.90%
Connecticut	7	52	13.46%	$ 2,696,934	$ 39,688,219	6.80%
Oregon	3	24	12.50%	$ 1,004,982	$ 14,945,592	6.72%
New Hampshire	2	10	20.00%	$ 589,018	$ 8,928,401	6.60%
Maine	5	11	45.45%	$ 1,945,862	$ 30,069,944	6.47%
Texas	34	334	10.18%	$ 11,776,986	$ 185,935,342	6.33%
Pennsylvania	45	212	21.23%	$ 16,266,855	$ 265,458,384	6.13%
South Carolina	5	48	10.42%	$ 1,615,891	$ 29,953,726	5.39%
Illinois	75	429	17.48%	$ 26,455,741	$ 501,426,313	5.28%
Georgia	28	143	19.58%	$ 9,644,044	$ 182,882,040	5.27%
Oklahoma	6	96	6.25%	$ 1,914,141	$ 38,463,976	4.98%
Indiana	15	108	13.89%	$ 5,399,409	$ 111,027,714	4.86%
Virginia	22	86	25.58%	$ 7,600,325	$ 157,222,006	4.83%
Michigan	20	101	19.80%	$ 7,465,363	$ 178,576,349	4.18%
						National Average
Arizona	4	48	8.33%	$ 1,646,104	$ 55,812,143	2.95%
Hawaii	2	9	22.22%	$ 871,600	$ 31,412,219	2.77%
North Dakota	1	21	4.76%	$ 376,359	$ 14,099,472	2.67%
Mississippi	1	14	7.14%	$ 303,433	$ 11,881,674	2.55%
Nebraska	2	47	4.26%	$ 762,062	$ 33,139,593	2.30%
Nevada	3	33	9.09%	$ 1,076,117	$ 51,306,956	2.10%
Utah	7	50	14.00%	$ 2,677,018	$ 135,216,644	1.98%
Washington	4	71	5.63%	$ 1,416,818	$ 72,415,135	1.96%
California	48	302	15.89%	$ 17,201,883	$ 934,173,517	1.84%
Alabama	8	60	13.33%	$ 2,641,401	$ 198,448,874	1.33%
Ohio	19	176	10.80%	$ 6,361,011	$ 615,117,523	1.03%
New York	37	173	21.39%	$ 12,741,881	$ 1,705,688,958	0.75%
Delaware	4	29	13.79%	$ 1,435,100	$ 193,331,325	0.74%
North Carolina	13	69	18.84%	$ 4,637,270	$ 1,084,997,215	0.43%
Rhode Island	1	12	8.33%	$ 289,027	$ 209,813,358	0.14%
Alaska	0	4	0.00%	$ -	$ 6,679,996	0.00%
American Samoa	0	0	0.00%	$ -	$ -	0.00%
District of Columbia	0	5	0.00%	$ -	$ 805,296	0.00%
Federated States of Micronesia	0	0	0.00%	$ -	$ -	0.00%
Guam	0	0	0.00%	$ -	$ -	0.00%
Puerto Rico	0	11	0.00%	$ -	$ 76,174,617	0.00%
South Dakota	0	17	0.00%	$ -	$ 63,453,286	0.00%
Vermont	0	3	0.00%	$ -	$ 4,075,871	0.00%
Virgin Islands	0	0	0.00%	$ -	$ -	0.00%

Source: FDIC Statistics on Depository Institutions database

Table 5: NCRC Sample of CRA Exams

Lender	City	State	Agency	CRA Exam Date
Farmers Bank & Trust Company	Magnolia	AR	FDIC	26-Nov-01
First Financial Bank	El Dorado	AR	FED	29-Oct-01
Pulaski Bank and Trust Company	Little Rock	AR	FED	11-Jun-01
The Citizens Bank	Batesville	AR	FED	26-Nov-01
The First National Bank of Springdale	Springdale	AR	OCC	07-Apr-03
The Malvern National Bank	Malvern	AR	OCC	16-May-02
FirstBank North	Westminster	CO	FDIC	18-Dec-01
FirstBank of Arapahoe County	Littleton	CO	FDIC	12-Apr-99
FirstBank of Aurora	Aurora	CO	FDIC	29-Mar-99
FirstBank of Avon	Avon	CO	FDIC	01-Jan-04
FirstBank of Boulder	Boulder	CO	FDIC	07-Nov-02
FirstBank of Cherry Creek	Denver	CO	FDIC	18-Dec-01
FirstBank of Douglas County	Castle Rock	CO	FDIC	05-Apr-99
FirstBank of Lakewood	Lakewood	CO	FDIC	24-Oct-01
FirstBank of Littleton	Littleton	CO	FDIC	19-Apr-99
FirstBank of Longmont	Longmont	CO	FDIC	02-Dec-02
FirstBank of South Jeffco	Littleton	CO	FDIC	06-Nov-02
FirstBank of Tech Center	Greenwood Villag	CO	FDIC	14-Nov-01
The Pueblo Bank and Trust Company	Pueblo	CO	FDIC	10-Feb-03
UMB Bank Colorado, National Association	Denver	CO	OCC	13-Nov-00
Union Colony Bank	Greeley	CO	FED	22-Apr-02
Arundel Federal Savings Bank	Baltimore	MD	OTS	01-Aug-02
Atlantic Bank	Ocean City	MD	FED	21-Jun-99
Bradford Bank	Baltimore	MD	OTS	01-Aug-03
Calvert Bank and Trust Company	Prince Frederick	MD	FDIC	01-Nov-99
Calvin B. Taylor Banking Company	Berlin	MD	FDIC	11-Jun-01
Carrollton Bank	Baltimore	MD	FDIC	01-Nov-03
County Banking and Trust Company	Elkton	MD	FDIC	25-Feb-02
Fredericktown Bank & Trust Company	Frederick	MD	FDIC	01-Jan-03
Hagerstown Trust Company	Hagerstown	MD	FDIC	28-Sep-01
Industrial Bank, National Association	Oxon Hill	MD	OCC	07-Oct-02
Key Bank and Trust	Randallstown	MD	FDIC	30-Nov-01
Leeds Federal Savings Bank	Baltimore	MD	OTS	16-Jun-03
The Annapolis Banking and Trust Company	Annapolis	MD	FED	03-Mar-03
The First National Bank of St. Mary's at Leonardtown	Leonardtown	MD	OCC	08-Apr-02
The Forest Hill State Bank	Bel Air	MD	FED	07-Apr-03
The Talbot Bank of Easton, Maryland	Easton	MD	FDIC	20-Feb-02
The Washington Savings Bank, FSB	Bowie	MD	OTS	08-Sep-03
Northfield Savings Bank	Northfield	VT	FDIC	25-Feb-03
Passumpsic Savings Bank	St. Johnsbury	VT	FDIC	27-Aug-01

Note: These are the banks and thrifts in the NCRC sample of CRA exams
More information on lending and investment levels of these banks
is available from NCRC at 202-628-8866.

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NCRC Analysis: Impact of Regulatory Proposal

Table 6: Branches and Deposits of "Small" Lenders by State

	Number of Branches ($250m-$500m)	Total Number of Branches	Percent of Branches	Deposits ($000's) ($250m-$500m)	Total Deposits ($000's)	Percent of Deposits
United States	7,985	87,357	9.14%	$ 302,317,254	$ 5,142,262,916	5.88%
Maine	146	504	28.97%	$ 3,494,555	$ 16,078,660	21.73%
South Dakota	88	444	19.82%	$ 2,306,156	$ 15,715,744	14.67%
Idaho	82	465	17.63%	$ 2,429,654	$ 12,570,977	19.33%
Vermont	46	263	17.49%	$ 1,370,488	$ 8,796,514	15.58%
New Hampshire	67	415	16.14%	$ 2,399,499	$ 29,649,882	8.09%
New Mexico	78	485	16.08%	$ 2,347,055	$ 16,743,685	14.02%
Louisiana	238	1,507	15.79%	$ 6,075,487	$ 52,625,735	11.54%
Montana	56	360	15.56%	$ 1,872,393	$ 11,293,009	16.58%
Massachusetts	315	2,073	15.20%	$ 16,038,575	$ 172,377,658	9.30%
Delaware	37	246	15.04%	$ 1,635,803	$ 96,807,745	1.69%
Missouri	297	2,146	13.84%	$ 11,137,381	$ 91,545,619	12.17%
Arkansas	178	1,297	13.72%	$ 6,401,656	$ 37,699,983	16.98%
Virginia	332	2,420	13.72%	$ 10,666,029	$ 129,718,555	8.22%
Colorado	179	1,315	13.61%	$ 7,904,402	$ 61,138,571	12.93%
Tennessee	272	2,024	13.44%	$ 9,800,455	$ 86,691,236	11.31%
Georgia	283	2,458	11.51%	$ 12,999,928	$ 124,878,271	10.41%
Iowa	174	1,516	11.48%	$ 5,829,036	$ 52,086,782	11.19%
Wisconsin	248	2,201	11.27%	$ 9,503,813	$ 95,909,221	9.91%
Kansas	158	1,459	10.83%	$ 4,711,683	$ 44,900,528	10.49%
Pennsylvania	495	4,580	10.81%	$ 16,970,299	$ 208,036,010	8.16%
Nebraska	103	970	10.62%	$ 3,053,728	$ 31,547,948	9.68%
Illinois	438	4,152	10.55%	$ 25,584,328	$ 281,031,114	9.10%
Kentucky	179	1,702	10.52%	$ 5,065,979	$ 56,075,725	9.03%
Maryland	177	1,684	10.51%	$ 7,033,251	$ 77,851,107	9.03%
Wyoming	21	204	10.29%	$ 809,458	$ 7,793,056	10.39%
Mississippi	110	1,108	9.93%	$ 3,487,058	$ 32,898,642	10.60%
Indiana	219	2,209	9.91%	$ 7,571,849	$ 80,341,611	9.42%
Alabama	140	1,430	9.79%	$ 4,076,635	$ 60,278,951	6.76%
Hawaii	29	297	9.76%	$ 808,982	$ 21,200,353	3.82%
Minnesota	158	1,676	9.43%	$ 6,995,572	$ 97,383,123	7.18%
Washington	165	1,776	9.29%	$ 4,572,152	$ 81,431,295	5.61%
			National Average			
Oklahoma	105	1,220	8.61%	$ 3,598,940	$ 44,323,803	8.12%
Michigan	233	2,961	7.87%	$ 7,623,333	$ 137,103,811	5.56%
Utah	45	573	7.85%	$ 1,918,517	$ 84,962,630	2.26%
Oregon	78	995	7.84%	$ 2,402,585	$ 35,845,728	6.70%
North Dakota	31	411	7.54%	$ 1,076,816	$ 10,986,297	9.80%
Ohio	290	3,890	7.46%	$ 9,845,362	$ 210,982,111	4.67%
Texas	371	5,130	7.23%	$ 13,571,953	$ 297,299,553	4.57%
West Virginia	46	641	7.18%	$ 2,223,868	$ 22,344,937	9.95%
South Carolina	83	1,252	6.63%	$ 2,820,881	$ 44,879,999	6.29%
Alaska	8	129	6.20%	$ 268,417	$ 5,710,390	4.70%
New Jersey	185	3,087	5.99%	$ 8,487,948	$ 196,287,253	4.32%
Connecticut	63	1,170	5.38%	$ 2,803,104	$ 69,611,515	4.03%
Florida	252	4,717	5.34%	$ 9,528,403	$ 268,162,940	3.55%
New York	244	4,609	5.29%	$ 11,398,817	$ 580,737,668	1.96%
North Carolina	116	2,450	4.73%	$ 2,920,792	$ 146,964,140	1.99%
District of Columbia	9	191	4.71%	$ 283,309	$ 31,168,970	0.91%
California	271	6,246	4.34%	$ 14,105,492	$ 612,037,647	2.30%
Nevada	17	444	3.83%	$ 1,186,245	$ 31,752,283	3.74%
Arizona	25	988	2.53%	$ 1,043,808	$ 55,965,630	1.87%
Rhode Island	5	228	2.19%	$ 255,325	$ 17,812,856	1.43%
American Samoa	0	5	0.00%	$ -	$ 134,826	0.00%
Guam	0	35	0.00%	$ -	$ 1,748,455	0.00%
Marshall Islands	0	3	0.00%	$ -	$ 30,150	0.00%
Micronesia	0	6	0.00%	$ -	$ 119,213	0.00%
N.Mariana	0	12	0.00%	$ -	$ 504,226	0.00%
Palau	0	3	0.00%	$ -	$ 82,672	0.00%
Puerto Rico	0	552	0.00%	$ -	$ 40,263,215	0.00%
Virgin Islands	0	23	0.00%	$ -	$ 1,342,688	0.00%

Source: FDIC Summary of Deposit database

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NCRC Analysis: Impact of Regulatory Proposal

Table 7: Branches and Deposits of "Small" Lenders in Rural Areas

	Number of Branches ($250m-$500m)	Total Number of Branches	Percent of Branches	Deposits ($000's) ($250m-$500m)	Total Deposits ($000's)	Percent of Deposits
United States	3,047	24,135	12.62%	$ 97,150,679	$ 756,464,322	12.84%
Maine	107	323	33.13%	$ 2,568,808	$ 8,795,658	29.21%
Delaware	14	54	25.93%	$ 499,575	$ 15,550,206	3.21%
South Dakota	77	314	24.52%	$ 2,092,043	$ 8,248,415	25.36%
Virginia	169	697	24.25%	$ 4,965,768	$ 20,243,650	24.53%
New Hampshire	51	216	23.61%	$ 1,900,378	$ 18,565,762	10.24%
Vermont	45	204	22.06%	$ 1,368,219	$ 6,036,132	22.67%
New Mexico	48	237	20.25%	$ 1,331,137	$ 6,452,063	20.63%
Louisiana	88	442	19.91%	$ 1,812,926	$ 10,555,336	17.18%
Pennsylvania	147	790	18.61%	$ 4,433,371	$ 25,041,185	17.70%
Washington	69	383	18.02%	$ 1,886,546	$ 11,188,919	16.86%
Ohio	145	867	16.72%	$ 4,417,365	$ 26,588,342	16.61%
Idaho	48	291	16.49%	$ 1,576,218	$ 7,361,852	21.41%
Maryland	30	196	15.31%	$ 1,205,234	$ 5,617,122	21.46%
Georgia	129	860	15.00%	$ 5,668,759	$ 31,862,267	17.79%
Kentucky	131	899	14.57%	$ 3,833,592	$ 25,439,730	15.07%
Montana	36	261	13.79%	$ 1,165,882	$ 7,531,591	15.48%
Tennessee	104	759	13.70%	$ 3,832,278	$ 22,222,472	17.25%
Oregon	43	330	13.03%	$ 1,286,446	$ 9,505,143	13.53%
Alabama	62	482	12.86%	$ 1,691,475	$ 15,394,838	10.99%
Michigan	96	759	12.65%	$ 2,035,623	$ 17,764,968	11.46%
			National Average			
Utah	20	161	12.42%	$ 434,237	$ 4,450,920	9.76%
Indiana	92	742	12.40%	$ 2,673,621	$ 22,484,011	11.89%
Missouri	117	955	12.25%	$ 3,992,588	$ 25,458,537	15.68%
Nebraska	77	630	12.22%	$ 2,449,610	$ 16,114,198	15.20%
Arkansas	84	697	12.05%	$ 3,377,640	$ 18,638,806	18.12%
Mississippi	86	733	11.73%	$ 2,804,237	$ 20,298,140	13.82%
Oklahoma	67	577	11.61%	$ 2,006,298	$ 16,712,680	12.00%
Florida	45	392	11.48%	$ 1,384,844	$ 13,250,555	10.45%
New York	60	523	11.47%	$ 2,001,015	$ 16,768,982	11.93%
Iowa	113	1044	10.82%	$ 3,717,418	$ 27,964,491	13.29%
Connecticut	14	131	10.69%	$ 643,672	$ 6,251,445	10.30%
Massachusetts	23	220	10.45%	$ 1,297,507	$ 9,473,636	13.70%
Kansas	81	820	9.88%	$ 2,471,142	$ 19,315,723	12.79%
South Carolina	36	370	9.73%	$ 1,294,554	$ 11,302,041	11.45%
Colorado	38	405	9.38%	$ 1,164,237	$ 12,181,843	9.56%
Illinois	96	1061	9.05%	$ 3,728,986	$ 31,138,138	11.98%
Texas	102	1144	8.92%	$ 3,858,333	$ 36,225,677	10.65%
Alaska	8	91	8.79%	$ 268,417	$ 3,002,123	8.94%
North Dakota	24	286	8.39%	$ 795,825	$ 6,466,932	12.31%
Hawaii	8	99	8.08%	$ 121,767	$ 4,121,442	2.95%
California	22	274	8.03%	$ 569,607	$ 11,649,279	4.89%
Wisconsin	71	887	8.00%	$ 2,641,084	$ 24,489,860	10.78%
Minnesota	52	780	6.67%	$ 1,994,424	$ 38,893,141	5.13%
Wyoming	10	162	6.17%	$ 357,423	$ 5,662,902	6.31%
North Carolina	43	841	5.11%	$ 777,713	$ 27,465,038	2.83%
West Virginia	19	381	4.99%	$ 752,837	$ 12,225,816	6.16%
American Samoa	0	5	0.00%	$ -	$ 134,826	0.00%
Arizona	0	127	0.00%	$ -	$ 4,957,093	0.00%
District of Columbia	0	0	0.00%	$ -	$ -	0.00%
Guam	0	35	0.00%	$ -	$ 1,748,455	0.00%
Marshall Islands	0	0	0.00%	$ -	$ -	0.00%
Micronesia	0	6	0.00%	$ -	$ 119,213	0.00%
N.Mariana	0	12	0.00%	$ -	$ 504,226	0.00%
Nevada	0	74	0.00%	$ -	$ 2,563,529	0.00%
New Jersey	0	0	0.00%	$ -	$ -	0.00%
Palau	0	3	0.00%	$ -	$ 82,672	0.00%
Puerto Rico	0	55	0.00%	$ -	$ 1,458,517	0.00%
Rhode Island	0	25	0.00%	$ -	$ 1,581,096	0.00%
Virgin Islands	0	23	0.00%	$ -	$ 1,342,688	0.00%

Source: FDIC Summary of Deposit database

NCRC Analysis: Impact of Regulatory Proposal
Table 8: Branches and Deposits of "Small" Lenders in Urban Areas

	Number of Branches ($250m-$500m)	Total Number of Branches	Percent of Branches	Deposits ($000's) ($250m-$500m)	Total Deposits ($000's)	Percent of Deposits
United States	4,938	63,222	7.81%	$ 205,166,575	$ 4,385,798,594	4.68%
Wyoming	11	42	26.19%	$ 452,035	$ 2,130,154	21.22%
Maine	39	181	21.55%	$ 925,747	$ 7,283,002	12.71%
Montana	20	99	20.20%	$ 706,511	$ 3,761,418	18.78%
Idaho	34	174	19.54%	$ 853,436	$ 5,209,125	16.38%
Massachusetts	292	1853	15.76%	$ 14,741,068	$ 162,904,022	9.05%
Arkansas	94	600	15.67%	$ 3,024,016	$ 19,061,177	15.86%
Colorado	141	910	15.49%	$ 6,740,165	$ 48,956,728	13.77%
Missouri	180	1191	15.11%	$ 7,144,793	$ 66,087,082	10.81%
Louisiana	150	1065	14.08%	$ 4,262,561	$ 42,070,399	10.13%
Wisconsin	177	1314	13.47%	$ 6,862,729	$ 71,419,361	9.61%
Tennessee	168	1265	13.28%	$ 5,968,177	$ 64,468,764	9.26%
Iowa	61	472	12.92%	$ 2,111,618	$ 24,122,291	8.75%
New Mexico	30	248	12.10%	$ 1,015,918	$ 10,291,622	9.87%
Kansas	77	639	12.05%	$ 2,240,541	$ 25,584,805	8.76%
Delaware	23	192	11.98%	$ 1,136,228	$ 81,257,539	1.40%
Minnesota	106	896	11.83%	$ 5,001,148	$ 58,489,982	8.55%
Illinois	342	3091	11.06%	$ 21,855,342	$ 249,892,976	8.75%
Hawaii	21	198	10.61%	$ 687,215	$ 17,078,911	4.02%
West Virginia	27	260	10.38%	$ 1,471,031	$ 10,119,121	14.54%
Maryland	147	1488	9.88%	$ 5,828,017	$ 72,233,985	8.07%
Georgia	154	1598	9.64%	$ 7,331,169	$ 93,016,004	7.88%
Virginia	163	1723	9.46%	$ 5,700,261	$ 109,474,905	5.21%
Pennsylvania	348	3790	9.18%	$ 12,536,928	$ 182,994,825	6.85%
Indiana	127	1467	8.66%	$ 4,898,228	$ 57,857,600	8.47%
South Dakota	11	130	8.46%	$ 214,113	$ 7,467,329	2.87%
Alabama	78	948	8.23%	$ 2,385,160	$ 44,884,113	5.31%
New Hampshire	16	199	8.04%	$ 499,121	$ 11,084,120	4.50%
			National Average			
Nebraska	26	340	7.65%	$ 604,118	$ 15,433,750	3.91%
Washington	96	1393	6.89%	$ 2,685,606	$ 70,242,376	3.82%
Texas	269	3986	6.75%	$ 9,713,620	$ 261,073,876	3.72%
Mississippi	24	375	6.40%	$ 682,821	$ 12,600,502	5.42%
Michigan	137	2202	6.22%	$ 5,587,710	$ 119,338,843	4.68%
Utah	25	412	6.07%	$ 1,484,280	$ 80,511,710	1.84%
New Jersey	185	3087	5.99%	$ 8,487,948	$ 196,287,253	4.32%
Kentucky	48	803	5.98%	$ 1,232,387	$ 30,635,995	4.02%
Oklahoma	38	643	5.91%	$ 1,592,642	$ 27,611,123	5.77%
North Dakota	7	125	5.60%	$ 280,991	$ 4,519,365	6.22%
South Carolina	47	882	5.33%	$ 1,526,327	$ 33,577,958	4.55%
Oregon	35	665	5.26%	$ 1,116,139	$ 26,340,585	4.24%
Ohio	145	3023	4.80%	$ 5,427,997	$ 184,393,769	2.94%
Florida	207	4325	4.79%	$ 8,143,559	$ 254,912,385	3.19%
Connecticut	49	1039	4.72%	$ 2,159,432	$ 63,360,070	3.41%
District of Columbia	9	191	4.71%	$ 283,309	$ 31,168,970	0.91%
Nevada	17	370	4.59%	$ 1,186,245	$ 29,188,754	4.06%
North Carolina	73	1609	4.54%	$ 2,143,079	$ 119,499,102	1.79%
New York	184	4086	4.50%	$ 9,397,802	$ 563,968,686	1.67%
California	249	5972	4.17%	$ 13,535,885	$ 600,388,368	2.25%
Arizona	25	861	2.90%	$ 1,043,808	$ 51,008,537	2.05%
Rhode Island	5	203	2.46%	$ 255,325	$ 16,231,760	1.57%
Vermont	1	59	1.69%	$ 2,269	$ 2,760,382	0.08%
Alaska	0	38	0.00%	$ -	$ 2,708,267	0.00%
American Samoa	0	0	0.00%	$ -	$ -	0.00%
Guam	0	0	0.00%	$ -	$ -	0.00%
Marshall Islands	0	3	0.00%	$ -	$ 30,150	0.00%
Micronesia	0	0	0.00%	$ -	$ -	0.00%
N.Mariana	0	0	0.00%	$ -	$ -	0.00%
Palau	0	0	0.00%	$ -	$ -	0.00%
Puerto Rico	0	497	0.00%	$ -	$ 38,804,698	0.00%
Virgin Islands	0	0	0.00%	$ -	$ -	0.00%

Source: FDIC Summary of Deposit database

National Community Reinvestment Coalition * http://www.ncrc.org * (202) 628-8866

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